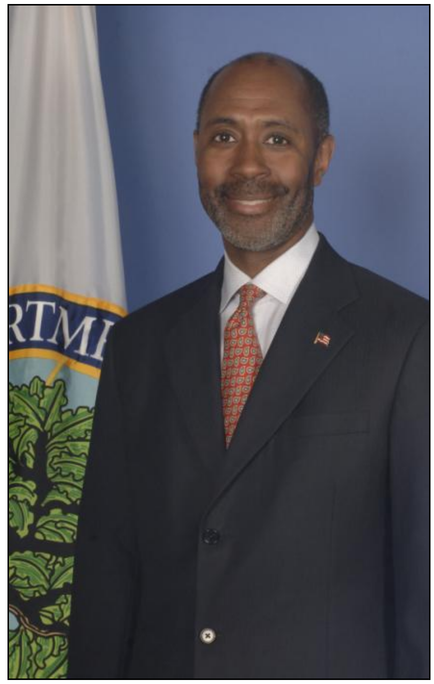
# Annual Report 2009

U.S. Department of Education | Federal Student Aid

START HERE
GO FURTHER
FEDERAL STUDENT AID

Dear Federal Student Aid Colleagues, Partners and Customers:



**William J. Taggart**
**Chief Operating Officer**

As someone who received federal financial assistance in college, I know how critical financial assistance can be in helping students pursue higher education. As the new Chief Operating Officer of Federal Student Aid, I am humbled by the opportunity to join the dedicated team charged with administering these same programs.

During 2009, Federal Student Aid faced many challenges including a change in administration, new amendments to our authorizing legislation, and a disruption in the financial markets that significantly impacted the federal student loan programs. I am proud to say that our organization successfully met these challenges while, at the same time, providing approximately $113 billion in financial aid to millions of students and their families.

In the year ahead, we will focus on continuing to implement the administration's top priorities to ensure college is more accessible and affordable, including simplifying the Free Application for Federal Student Aid and expanding operational capabilities. Significant efforts will be expended to assist those organizations that participate in our programs to prepare for these changes. Our commitment to increasing program integrity and enhancing customer service will only be surpassed by our dedication to improving stewardship of taxpayer resources. Above all, we will continue to invest in our employees to ensure their readiness to meet the evolving needs of our customers.

None of the accomplishments outlined in the coming pages would have been possible without the dedication of the Federal Student Aid workforce. I would like to congratulate them for their accomplishments over the past year and extend my sincerest gratitude for their commitment to improving our programs in the years to come. In tribute to these remarkable public servants, I proudly present the 2009 Federal Student Aid Annual Report.

Sincerely,

William J. Taggart
Chief Operating Officer

# Management's Discussion and Analysis

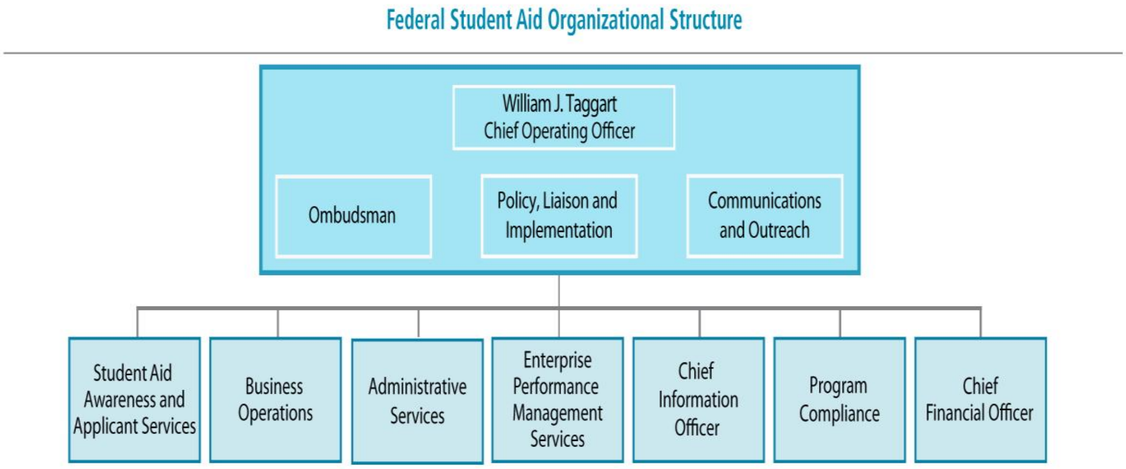
## Mission and Organizational Structure

Federal Student Aid, a principal office of the United States (U.S.) Department of Education (Department), seeks to ensure that all eligible individuals can benefit from federally funded or federally guaranteed financial assistance for education beyond high school. We consistently champion the promise of postsecondary education to all Americans – and its value to our society. Federal Student Aid plays a central and essential role in supporting postsecondary education. We partner with postsecondary schools, financial institutions and other participants in Title IV of the *Higher Education Act (HEA) of 1965*, *as amended* student financial assistance (Title IV) programs to deliver programs and services that help students finance their education beyond high school. Today, Federal Student Aid is responsible for a range of critical functions that include, among others:

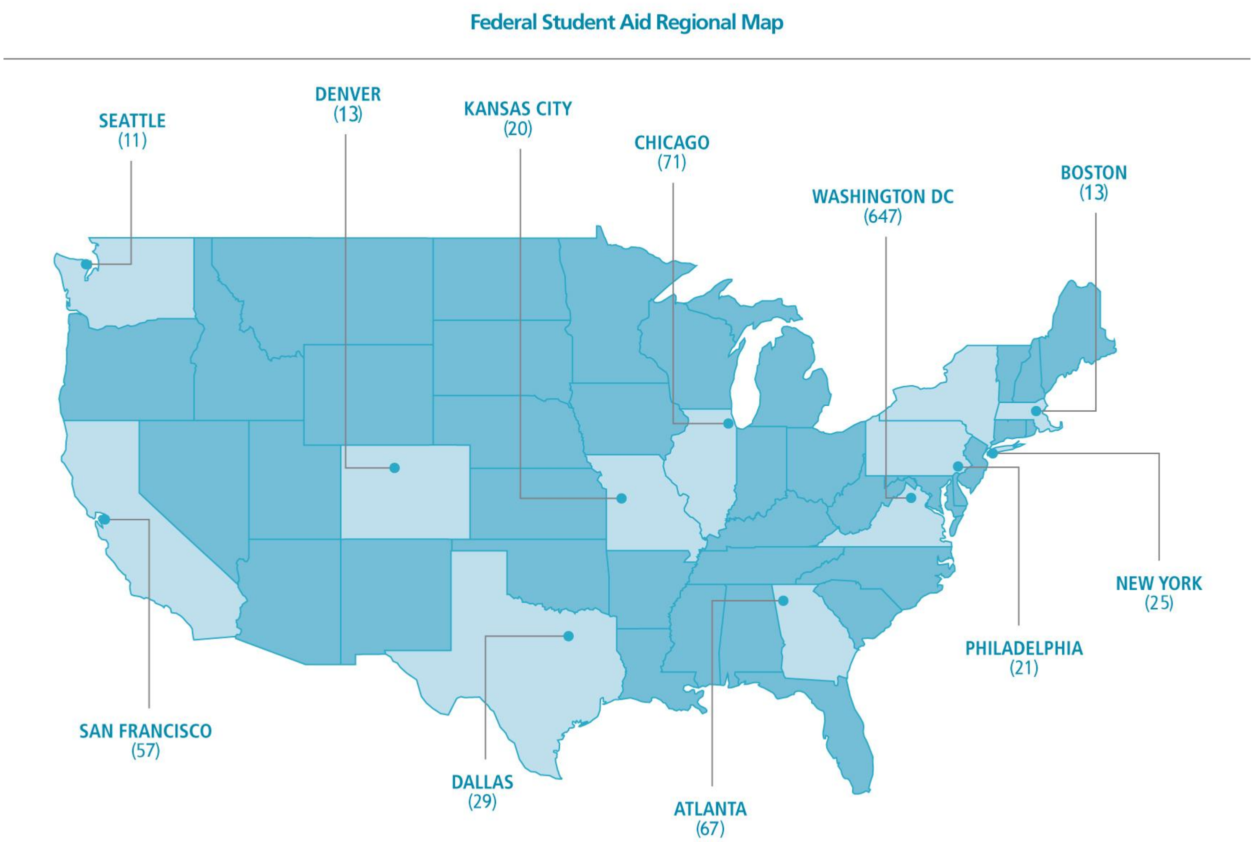
- Processing millions of student financial aid applications.
- Disbursing billions of dollars in aid funds to students through schools.
- Enforcing financial aid rules and regulations.
- Educating students and families on the process of obtaining aid.
- Servicing millions of student loan accounts.
- Securing repayment from borrowers who have defaulted on their loans.
- Operating information technology (IT) systems and tools that manage billions in student aid dollars.

This is a complex, multifaceted mission that calls on a range of staff skills and demands coordination by all levels of management. Designated as a Performance-Based Organization (PBO) by Congress in 1998, Federal Student Aid emphasizes tangible results and efficient performance, as well as the continuous improvement of the processes and systems that support our mission.

Federal Student Aid currently operates under a functional organizational structure that aligns our organization closely with our strategic drivers, business objectives and mission goals. This structure reinforces a key business goal: efficient, effective and productive interaction with our many stakeholders. This community of stakeholders includes students and parents, schools, lenders, guaranty agencies and taxpayers, as well as other federal entities and the Department itself. The following graphic illustrates the current functional organizational structure of Federal Student Aid.




A Chief Operating Officer, who is appointed to a five-year term by the Secretary of Education, leads Federal Student Aid. In June 2009, the Secretary appointed William J. Taggart as the organization's third Chief Operating Officer. During fiscal year (FY) 2009, the organization operated on an annual administrative budget of approximately $693 million. Federal Student Aid operates as a public-private partnership staffed by approximately 1,000 full-time employees and is augmented by contractors who provide outsourced business operations. This workforce is based out of Washington, D.C., with ten regional offices located throughout the country as reflected in the following graphic.



As a federally designated PBO, Federal Student Aid operates under a congressional mandate to achieve concrete mission results as it improves efficiency in operations, and manages and mitigates risks in Title IV portfolio performance. Federal Student Aid has focused on innovations for upgrading student aid delivery and servicing operations, and improving vendor and contract management, budgeting and cost control as well as financial and operational management. Much of the resulting operational performance improvement stems from business process re-engineering and large-scale technology integration.

Federal Student Aid is responsible for helping students manage the costs of education beyond high school. This duty includes administering the federal student financial assistance programs authorized under Title IV. The Title IV programs collectively represent the nation's largest source of financial aid for postsecondary students. In the paragraphs that follow, each of the major Title IV programs that deliver aid to students and their families is described.

In FY 2009, Federal Student Aid delivered or supported the delivery of approximately $113 billion in grant, work-study and loan assistance to almost 13 million postsecondary students and their families. These students attend approximately 6,200 active institutions of postsecondary education accredited by dozens of agencies. Many of these students also receive loans from approximately 2,900 lenders with 35 agencies administering the guarantee on those loans.

The **Federal Pell Grant (Pell Grant) Program** helps ensure financial access to postsecondary education by providing grant aid to low-income and middle-income undergraduate students. As the most need-based of the Department's student aid programs, Pell Grants vary according to the financial circumstances of students and their families. For the 2008–09 award year, the Department disbursed $18.4 billion in Pell Grants averaging approximately $2,973 to 6.2 million students. The maximum Pell Grant award was $4,731 for the 2008–09 award year. The maximum Pell Grant award increased to $5,350 for the 2009–10 award year. The *American Recovery and Reinvestment Act of 2009* (*Recovery Act*), enacted on February 17, 2009, by Public Law (P.L.) 111-5 continues the Department's goal of making college affordable by providing additional Pell Grant authority for low-income and middle-income undergraduate students.

The **Academic Competitiveness Grant (ACG)** and **National Science and Mathematics Access to Retain Talent (SMART) Grant Programs** were created by the *Higher Education Reconciliation Act of 2005 (HERA)*, signed into law in 2006. The ACG is for full-time undergraduates who meet Pell Grant eligibility requirements. The student must have completed a rigorous high school program, as determined by the state or local education agency and as recognized by the Secretary of Education. First-year students may receive an ACG award up to $750, whereas second-year students may receive up to $1,300 if they have maintained a cumulative grade point average of at least 3.0. The ACG award became available in the 2006–07 school year for first-year students who graduated high school after January 1, 2006, and second-year students who graduated high school after January 1, 2005. The ACG award is in addition to the student's Pell Grant award. For the 2008–09 academic year, $343 million in ACG awards were disbursed to approximately 452,000 students.

The National SMART Grant Program provides up to $4,000 to third- and fourth-year undergraduates studying full-time and majoring in physical, life or computer sciences, mathematics, technology, engineering or a foreign language critical to national security. The student must meet Pell Grant eligibility requirements. The student must maintain a cumulative grade point average of at least a 3.0 for coursework required for the major. The grant award is in addition to the student's Pell Grant award. A student cannot receive more than one ACG or National SMART Grant award in each academic year for which they are eligible. For the 2008–09 academic year, $201 million in National SMART grants were disbursed to approximately 71,000 students.

**The Teacher Education Assistance for College and Higher Education (TEACH) Grant**, authorized by the *College Cost Reduction and Access Act of 2007* (*CCRAA*), provides up to $4,000 per year to students agreeing to teach mathematics, science, or other specialized subjects in a high-poverty school for at least four years within eight years of their graduation. If students fail to fulfill the service requirements, grants convert to Unsubsidized Stafford Loans, with interest accrued from the time of the grant award. This grant program began in the 2008–09 school year, starting July 1, 2008. In FY 2009, the Department disbursed approximately 15,000 grants for almost $44 million under TEACH.

The **Federal Supplemental Educational Opportunity Grant (FSEOG)**, the **Federal Work-Study (FWS)** and the **Federal Perkins Loan Programs** are three campus-based programs through which the Department provides funds directly to eligible institutions, enabling them to offer grants, employment and low-interest loans to students based on need. For the 2008–09 award year, approximately $3.5 billion were disbursed through approximately 2.7 million campus-based awards. The *Recovery Act* continues the Department's goal of making college affordable by increasing the amount of grants available as part of the FWS program. As a result of the *Recovery Act*, FWS funding increased by $200 million in FY 2009. Also, the President's FY 2010 budget request proposes an increase in the new Perkins Loan Program from $1 billion to $6 billion annually. Participating colleges and universities would increase from 1,800 to 4,400 institutions.

There are two state grant programs. The **Leveraging Educational Assistance Partnership (LEAP) Program**, authorized by Section 415A of the *HEA*, makes federal funds available to assist states in providing student financial assistance programs for individuals with substantial financial need. The **Special Leveraging Educational Assistance Partnership (SLEAP) Program** was added to the LEAP Program in the 1998 Amendments to the *HEA* (Section 415E). SLEAP makes federal funds available to states to cover a third of the cost of supplementing their respective LEAP programs, supplementing their LEAP Community Service Work-Study programs and/or providing Merit and Academic Achievement or Critical Careers Scholarships to students with substantial financial need. For the 2008–09 academic year, approximately $162 million in LEAP grants were disbursed to approximately 162,000 students.

In fulfilling our program responsibilities, Federal Student Aid directly manages or oversees almost $622 billion in outstanding loans—representing over 111 million student loans to more than 32 million borrowers.

The **William D. Ford Federal Direct Loan (Direct Loan sm) Program sm** lends funds directly to students and parents through participating schools. This program is funded by borrowings from the U.S. Department of the Treasury (Treasury), as well as an appropriation for subsidy costs. In FY 2009, the Department made $22.3 billion[1] in net loans to 2.9 million recipients.

Under the **Federal Family Education Loan (FFEL sm) Program sm**, students and parents may obtain loans through private lenders. Loan guaranty agencies insure these loans and they are, in turn, reinsured by the federal government.

During FY 2009, Federal Student Aid supported the delivery of $67.9 billion[2] in net loans to 7.7 million FFEL recipients. In addition, Federal Student Aid made gross payments of approximately $5.4 billion to lenders for interest and special allowance subsidies and $11.9 billion to guaranty agencies for reinsurance claims and fees paid to guaranty agencies for loan processing, issuance and account maintenance. Total principal balances outstanding of guaranteed loans held by lenders were approximately $457 billion as of September 30, 2009 with a maximum government exposure of $445 billion.

In August 2008, the Department implemented a number of programs authorized under the *Ensuring Continued Access to Student Loans Act of 2008* (*ECASLA*) (P.L. 110-227) to ensure credit market disruptions did not deny eligible students and parents access to federal student loans for the 2008–09 academic year. The *ECASLA* authority, which originally expired on September 30, 2009, was subsequently extended through September 30, 2010, to continue to ensure unfettered access to loans through the 2009–10 academic year. Programs authorized under *ECASLA* are summarized below along with FY 2009 activity. For additional information on the Loan Purchase Programs authorized under ECASLA, please see Loan Purchase Programs in the Key Performance and Results Section. Also, more information on these programs can be found at http://www.federalstudentaid.ed.gov/ffelp.

[1] Excludes consolidation loans of $13.9 billion.
[2] Excludes consolidation loans of $0.2 billion.

## Performance Goals, Objectives and Results

This section provides a high-level overview of Federal Student Aid's FY 2009 performance objectives and results. The information provides a summary of our achievements and progress in meeting both the organization's stated performance standards and those critical functions that were not included in the FY 2006 – 2010 Five-Year Plan.

We have introduced many substantial and measurable improvements in how we plan and report operational and portfolio performance in administering the federal student financial assistance programs since Federal Student Aid became a PBO in 1998.

**Strategic Planning and Reporting.** Several key strategic drivers form the scope and content of Federal Student Aid's long-term goals and objectives:

- *HEA* Legislation.
- Legislation and Budget Requirements.
- Federal Financial Management Laws and Regulations.
- Customer Needs.
- PBO Legislation.
- The Department's Strategic Plan.
- The Department's Management Challenges.

The foundation of our long-term strategic planning is Federal Student Aid's five core strategic objectives. Taken collectively, these objectives provide the framework for continuous improvement at Federal Student Aid, guiding us in managing our programs more effectively and providing clear strategic direction to all of Federal Student Aid's internal and external constituencies.

Our core strategic objectives are to:

- Integrate Federal Student Aid systems and provide new technology solutions.
- Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.
- Reduce program administration costs.
- Improve human capital management.
- Improve products and services to provide better customer service.

Federal Student Aid's long-term planning is outlined in its Five-Year Plan, a statement of strategic direction providing long-term guidance. Beginning with the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. The Five-Year Plan aligns with Federal Student Aid's annual, tactical business-level planning, tracking and implementation processes including the Annual Performance Plan.

**Tactical Performance Planning and Reporting.** Federal Student Aid's Annual Performance Plan establishes specific tactical initiatives to achieve organizational strategic objectives outlined in the Five-Year Plan. Timelines, milestones and status are maintained in the Annual Performance Plan and evaluated on a monthly basis to ensure their alignment with current business needs, the allocation of resources and capital, policy considerations and statutory and regulatory requirements.

The Annual Report provides the mechanism for reporting the organization's annual performance results, including the organization's audited financial statements, a summary of the organization's progress in meeting tactical goals established in the Annual Performance Plan and detailed results of the organization's success in meeting performance standards established in the Five-Year Plan. These documents—the Five-Year Plan, the Annual Performance Plan and the Annual Report—form the foundation of Federal Student Aid's strategic planning, tactical implementation and reporting processes.

## Key Performance Goals and Results

This section provides a high-level overview of Federal Student Aid's FY 2009 performance objectives and results. The information provides a summary of our achievements and progress in meeting the organization's stated performance standards.

In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the FY 2006 and the FY 2010 targets. Because Federal Student Aid has not updated that plan, performance standards have changed, and interim year targets, where developed, may not have been published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

The underlying assumptions in Federal Student Aid's performance planning and reporting processes stem from the Five-Year Plan and are based on current budgetary, operational and policy considerations. However, during FY 2009, Federal Student Aid was faced with many challenges and unanticipated events that forced the organization to reallocate much-needed human and capital resources. Most notably was the disruption to the credit markets and its impact on FFEL Program lenders, the change in administration and new priorities that resulted from these events. As a result, many previously identified tactical objectives were reprioritized contributing to the organization's inability to achieve many previously identified performance targets.

Nonetheless, during FY 2009, Federal Student Aid made progress in meeting a majority of our performance standards. For the most recent data available, Federal Student Aid met targets for eight key measures, showed improvement on two measures and did not meet targets for eight measures. Federal Student Aid discontinued two measures and measured performance for three measures that did not have standards or targets established. The organization continues to analyze the impact of portfolio performance on the Cumulative Lifetime Default Rate (CLTDR) before identifying future performance targets as noted below.

The actual results for each performance standard are presented in conjunction with each objective. The respective tables present whether the actual result met or failed to meet the target. In some cases, establishing a baseline is the target and is recognized as met if the baseline was established. Note: Because performance standards were established in the FY 2006 – 2010 Five-Year Plan, historical data may not be available for some of the indicated standards because the Department did not collect the data prior to FY 2006.

Please see the Annual Program Performance Report section of this report for applicable footnotes and more specific accomplishments, by objective.

The Performance Results Summary Table on the following page uses the following notations:

- "Met" represents that performance results met or exceeded the target.
- "Not met" represents that performance results fell short of the target.
- "Improved" represents that the performance results improved over the prior year but fell short of the target.
- "PM" represents that the measured performance, standards and/or targets were not established.
- "T" represents that the measure was replaced or discontinued.
- "NA" represents that the data is not available.

## Performance Results Summary Table Fiscal Years 2007 – 2009

| Performance Results Summary | FY 2007 | FY 2008 | FY 2009 |
|---|---|---|---|
| **Objective 1 – Integrate Federal Student Aid systems and provide new technology solutions.** | | | |
| Integrated Partner Management (IPM) | Met | Not met | Not met |
| Integrate aid delivery systems* | Met | Not met | Met |
| Acquisition strategy | Met | Not met | Met |
| Infrastructure | Met | Met | Met |
| **Objective 2 – Improve program integrity to facilitate access to postsecondary education, while reducing vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.** | | | |
| President's Management Agenda (PMA) scorecard | | | |
| A. Financial management | Met | Met | T |
| B. Improper payments | Met | Met | T |
| CLTDR – Title IV student loan portfolio | PM | PM | PM |
| National Cohort Default Rate (CDR) | Met | Met | Not met |
| Direct Loan default recovery rate | Met | Met | Not met |
| FFEL default recovery rate | Met | Met | Not met |
| **Objective 3 – Reduce program administration costs.** | | | |
| Reduce electronic Free Application for Federal Student Aid (FAFSA^sm) direct unit cost | Met | Met | Met |
| Reduce origination and disbursement direct unit cost | Met | Met | Met |
| Reduce Direct Loan servicing direct unit cost | Not met | Improved | Improved |
| Reduce collections direct unit cost | Met | Not met | Improved |
| **Objective 4 – Improve human capital management.** | | | |
| Leadership training | Met | Met | Not met |
| Acquisitions training | Met | Met | Met |
| Project management training | Not met | Not met | Met |
| Federal Student Aid business knowledge training | Met | Not met | Not met |
| School compliance officials training | Met | Not met | Not met |
| General workforce training | Met | Not met | Not met |
| **Objective 5 – Improve products and services to provide better customer service.** | | | |
| Student aid application | Not met | Met | Met |
| Lender payment processing | Met | Met | PM |
| Direct Loan borrower servicing | Met | Met | PM |

*In June 2009, the target for Debt Management Collection System (DMCS) was updated to reflect that the procurement was changed from having a new system built to a procurement contract for a service. The original schedule to do all requirements and produce a system was estimated at 24 months. In procuring a service, as a replacement to the default processes, we are expecting to be fully operational by the end of 2010.

As previously noted, there were several other planned and unplanned initiatives that forced the organization to re-prioritize much-needed human and capital resources. The following is a brief summary of the unanticipated events that influenced Federal Student Aid's performance planning and execution processes in FY 2009.

**New Administration.** On January 20, 2009, Barack H. Obama was sworn in as the 44th President of the United States. Federal Student Aid and the Department immediately began the transition of implementing the new President's agenda and policies for federal financial aid. This included implementation of the *Recovery Act* and preparations for implementation of the President's FY 2010 budget request. Another higher education priority of President Obama includes simplification of the FAFSA. To lead student financial aid efforts, Secretary Arne Duncan appointed William J. Taggart as the Chief Operating Officer of Federal Student Aid on June 1, 2009.

***Recovery Act.*** In February 2009, President Obama signed the *Recovery Act* into law. The *Recovery Act* provides an additional $17 billion for Pell Grants in FY 2009 and FY 2010; the FY 2009 funding is $16.2 billion, with 6.1 million students participating. In addition to increases in the *CCRAA*, the *Recovery Act* increased the maximum Pell Grant award to $5,350 in the first year. The *Recovery Act* also increased FWS by $200 million in academic year 2009.

**The President's FY 2010 Budget Request.** In February 2009, the President also released proposals for the FY 2010 budget, which included increasing the maximum Pell Grant award to $5,550 and making the Pell Grant Program mandatory. The President proposed that beginning in July 2010 all new federal student loans would be originated through the Direct Loan Program. The budget request calls for an expansion of the Perkins Loan Program from its current new loan volume of $1 billion to $6 billion. Colleges and universities participating in the Federal Perkins Loan Program would increase from 1,800 to as many as 4,400.

As a result of the unanticipated events described above, Federal Student Aid had to revise its performance plans and reassess priorities. Below are descriptions of some of the select priorities for Federal Student Aid in FY 2009.

**Loan Purchase Programs.** On May 7, 2008, President Bush signed the *ECASLA*. The legislation provided the Department with the authority to address concerns about the availability of FFEL Program loans for the upcoming academic year. *ECASLA* also increased annual and aggregate loan amounts in the FFEL as well as Direct Loan programs plus provided relief for certain Parent Loan for Undergraduate Students (PLUS) Loan borrowers whose adverse credit history is related to payments on home mortgages or medical bills.

In May 2008, based on the authority granted by *ECASLA*, the Secretary announced a comprehensive plan to ensure that all eligible students (and their parents) had access to federal student loans for the 2008–09 academic year. That plan included four key components:

1. An offer to purchase FFEL Program loans made for the 2008–09 academic year from lenders and thereby offering lenders access to short-term liquidity;

2. A pledge to work with the student lending community on forward-looking solutions to ensure the FFEL Program and other student lending programs serve the best interests of students and taxpayers for years to come;

3. An enhanced lender-of-last-resort program designed to provide access to FFEL Program loans for those students who face difficulty obtaining conventional loans; and

4. A more efficient Direct Loan Program with increased capacity.

A key component of this plan was the development and implementation of two loan purchase programs to provide immediate liquidity to FFEL lenders.

1. Loan Participation Purchase Program – Under the Loan Participation Purchase Program, the Department offered to purchase through September 30, 2009, "participation interests" in pools of FFEL loans made for the 2008–09 academic year. By October 15, 2009, lenders must have either redeemed those loans or sold them outright to the Department.

    - Under this program, the lender pays the Department a yield on its participation interest calculated as the three-month commercial paper rate reported by the Federal Reserve in Publication H-15 plus 50 basis points on the principal amount of loans in which the Department purchased a participation interest.

2. Loan Purchase Commitment Program – Under the Loan Purchase Commitment Program, the Department offered to purchase eligible FFEL loans made for the 2008–09 academic year through October 15, 2009.

    - The Department's purchase price is equal to the total of the (1) outstanding principal balance of the loan, plus (2) accrued interest, plus (3) a refund of the one percent lender origination fee paid to the Department on the amount disbursed, plus (4) $75 per loan.

The 2008–09 Loan Purchase Programs will conclude on October 15, 2009. As of September 30, 2009, lenders participating in the 2008–09 Program had requested and the Department purchased participation interests in pools of loans totaling $33.3 billion. In addition, lenders had requested the Department purchase outright approximately $23.8 billion in eligible 2008–09 loans through the 2008–09 Loan Purchase Commitment Program. Of these, approximately $10.1 billion or 42 percent of these loans were initially funded from the 2008–09 Participation Program. The $23.8 billion represents the gross amount the Department paid for the loans and includes accrued interest, $75 per loan and the rebate of the 1 percent origination fee. More information on the closeout of the 2008–09 Program is provided in the Annual Program Performance Report section of this report.

**Replication of the Loan Purchase Programs for the 2009–10 Academic Year.** Under the initial programs, the Department purchased loans that had already been made by lenders, or participation interests in those loans on which the lenders had made at least a first disbursement. This required lenders to obtain short-term financing from private sources in order to make the loans. In addition, only 2008–09 loans would be eligible to be sold to the Department through these programs.

With more than $65 billion in 2007–08 loans and approximately $130 billion in eligible 2003–07 student loans on bank balance sheets and auction rate securitizations, the capital markets were unable to generate adequate funds at prices that would ensure 2009–10 loans could be made. As conditions in the credit markets continued to deteriorate, lenders were faced with a decision whether to commit to providing loans to schools for the coming academic year. The Department began hearing concerns from both the school and lender communities that assistance was needed to ensure 2009–10 loans would be available.

In October 2008, the President signed a one-year extension of authorities contained in *ECASLA*. In early November 2008, the Secretary announced a plan to ensure availability of federal student loans for the 2009–10 academic year by replicating the 2008–09 loan purchase programs for the 2009–10 academic year. Under the plan, the 2008–09 loan purchase programs would conclude as designed and the Department would offer the same programs, on substantially the same terms, for loans made for the 2009–10 academic year.

Results for the 2009-10 Loan Purchase Programs included:

- As of September 30, 2009, 28 lenders had entered into Master Participation Agreements with the Department for the 2009-10 academic year. The Department has, to date, purchased participation interests under these agreements totaling $7.9 billion.

- As of September 30, 2009, 36 lenders had entered into Master Loan Sale Agreements for the 2009-10 academic year with the Department. Two of these lenders have requested the Department purchase eligible loans in late October 2009 totaling $14.5 million.

**Asset-Backed Commercial Paper (ABCP) Conduit.** In addition to the Loan Purchase and Loan Participation Purchase Programs, the Department has entered into a Put Agreement with a newly-created ABCP conduit and agreed to enter into such agreements on the same terms with other conforming conduits.

Under a Conduit program, a special purpose entity (the Conduit) issues commercial paper to investors to finance its acquisition of interests in federally-reinsured student loans made between October 2003 and September 2009. The commercial paper is backed by the Conduit's interest in these loans. The Conduit uses proceeds of these sales to acquire these interests from lenders. Lenders that sell interests to the conduit must commit to provide new loans for the coming academic years with a portion of the proceeds of the sale. To ensure that the Conduit will have the resources to meet investor demands on maturing commercial paper if it is unable to reissue that paper or meet that demand from its own resources, the Department entered into a forward purchase commitment (a Put Agreement) with the Conduit, under which the Department agreed to purchase pledged loans from the Conduit at a prearranged price as and when needed to ensure that the Conduit can meet these demands of its investors. In addition, the Federal Financing Bank has entered into a Liquidity Loan Agreement with the Conduit to provide immediate advances as needed by the Conduit.

Results for the ABCP Conduit included:

- The Conduit first issued commercial paper in May 2009 and as of September 30, 2009, $29.9 billion was issued.

**Establishment of a Short-Term Loan Purchase Program for the 2007–08 Academic Year**. Until the time that the first Conduit became operational, lenders continued to struggle to obtain funds to make loans, in particular to make second disbursements when needed on loans for the 2008–09 academic year.

To address this need, in late November 2008, the Secretary announced that the Department would use its loan purchase authority to purchase certain 2007–08 academic year FFEL Program loans. This short-term use of the purchase authority was designed to prevent disruption in student lending prior to the ABCP Conduit Program becoming operational.

Under this program, the Department offered to buy FFEL Program loans disbursed between May 1, 2007 and September 30, 2008, for a loan period beginning on or including July 1, 2007. Under this program, the Department agreed to purchase up to $500 million in loans each week that the program was operational, at 97 percent of the balance owed on the loan. Lenders were required to use a portion of the proceeds of the sale to make new FFEL loans.

Results for the 2007-08 Short-term Loan Purchase Programs included:

- By February 25, 2009, the Department accepted final offers to purchase eligible loans under the 2007–08 Loan Purchase Commitment Program and completed those purchases by March 9, 2009. Under this program, the Department purchased loans totaling approximately $1 billion.

**Direct Loan Capacity.** As a result of the state of the credit markets and subsequent passage of the *ECASLA*, the Department prepared to acquire a large volume of federally guaranteed student loans. In addition, schools began to enroll and participate in the Direct Loan Program to ensure a stable source of loans for their students. In fact, the number of schools originating loans in the Direct Loan Program increased 42 percent between June 30, 2008 and June 30, 2009. Finally, the President's FY 2010 budget proposes originating all new federal student loans through the Direct Loan Program starting in FY 2010.

The Department invested considerable resources over the past 18 months to increase both the Direct Loan origination and servicing capacity. This was required primarily as a result of the disruption in the credit markets and the impact of that disruption on the FFEL Program. Last year, we completed a major capacity upgrade to the Department's Common Origination and Disbursement System which manages the origination and disbursement process for the Direct Loan Program as well as many federal grant programs. In June 2009, several servicing contracts were awarded to private sector servicing firms to increase the Department's student loan servicing capacity to improve service to students and reduce borrower defaults. This servicing capacity was operational by September 1, 2009.

The selected contractors will service Direct Loans and FFEL loans being acquired by the Department under the ECASLA loan purchase programs. The award of these contracts provides the Department with the capacity necessary to support anticipated increases in the number of loans owned by the Department and ensures borrowers will receive the assistance they need to effectively manage their federal student loan obligations.

**FAFSA Simplification.** Part of the transition to a new administration includes implementing the President's priorities, one of which includes making a college education more accessible for Americans. To do this, the Secretary was charged with simplifying the FAFSA. Federal Student Aid designed and began to implement the changes necessary to achieve the President's goal. Federal Student Aid made a series of improvements to the online application. Although over 95 percent of students apply online, much of the online form simply reproduces the paper version rather than taking advantage of the interactive potential. On June 24, 2009, Secretary Duncan announced a shorter and simpler online application that skips unnecessary questions and provides students with instant estimates of Pell Grant and student loan eligibility, rather than requiring them to wait weeks. It also provides a link to more college information such as graduation rates. Federal Student Aid continues to work to provide a series of additional improvements that will be implemented in January 2010.

**Budgetary Impact.** Funding for student aid administration totaled $753 million for FY 2009. The FY 2009 administrative costs were significantly impacted by the administration's efforts to originate and service the increased Direct Loan volume, implement the loan purchase and participation initiatives authorized by the *ECASLA* and simplify the financial aid process. To fund these activities, the Department deferred planned projects and used a portion of the additional $60 million provided by the *Recovery Act*.

## Achievements in Support of Federal Student Aid Strategic Objectives

**Objective 1: Integrate Federal Student Aid systems and provide new technology solutions.** In FY 2009, Federal Student Aid continued its focus on integration initiatives designed to improve accuracy and availability of the most critical information maintained throughout the financial aid lifecycle, specifically borrower, school and financial partner data. These initiatives are coordinated to present a more integrated and thus holistic view of borrower information to a variety of stakeholders within Federal Student Aid and the financial aid community. In FY 2009, Federal Student Aid established a Comprehensive Security Program to respond to the increasing need to provide additional protection of our data and oversight and monitoring of our systems. Federal Student Aid continued to establish the components of our new procurement and management approach to business application development.

**Objective 2: Improve program integrity to facilitate access to postsecondary education, while reducing the vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.** Federal Student Aid improved its oversight of schools by partnering with and utilizing the data of other federal agencies that have monitoring responsibilities of postsecondary institutions such as the Federal Bureau of Investigation (FBI). For example, Federal Student Aid began conducting joint campus security site visits with the FBI to increase monitoring. In FY 2009, program review standards were enhanced to strengthen monitoring of distance education programs. Federal Student Aid continued process improvement for monitoring of the financial performance of publicly-traded schools and large school groups under common ownership. Referral processes between Federal Student Aid Business Operations and Federal Student Aid Program Compliance were also enhanced to more aggressively identify schools having program reconciliation problems. Additionally, Federal Student Aid continued to effectively monitor lenders, guaranty agencies and servicers that participate in the FFEL Program. During FY 2009, Federal Student Aid focused its efforts in the areas of 9.5 percent Special Allowance Payments (SAP), implementation of the *ECASLA* programs and other focused risk areas, such as conflict of interest, consolidation loan rebate fees and eligible lender trustee (ELT) relationships.

**Objective 3: Reduce program administrative costs.** Federal Student Aid continued to focus on reducing costs through efficiency and productivity gains that can be achieved throughout the organization. In 2009, Federal Student Aid experienced significant increases in workload volumes across several Federal Student Aid programs and processes. This included approximately a 22 percent increase in applications processed, a 42 percent increase[3] in the number of schools originating loans in the Direct Loan Program, and a 26 percent increase[4] in Pell Grants disbursed. We anticipate these and other workload volumes will continue to increase in the coming years, driving down unit costs but increasing gross costs. In the future, we will look at a more balanced approach to cost management to ensure a "best value" proposition to the government and our customers. This approach will consider several variables to gauge cost management including measurement of unit cost and the relative impact of unit cost fluctuations on programmatic and systemic risk as well as customer service levels, among others.

[3] Represents the increase between the 2007-08 award year and the 2008-09 award year.
[4] Represents the increase between the 2007-08 award year and the 2008-09 award year.

**Objective 4: Improve human capital management.** In FY 2009, Federal Student Aid began to develop and implement a succession strategy to "build leaders at all levels." Federal Student Aid initiated a hiring freeze beginning July 1, 2008, and slowly began hiring new staff in March 2009. The organization dedicated itself to training the workforce in the fundamentals of its business and other mission-critical areas, building strong current and future leaders and aligning staff in organization structures designed for high performance. Some examples of training courses include:

- *Cornerstones of Supervision* which is a 35-hour supervisory skill-building program to develop individual assessments, group discussion, exercises and application to focus on the art and practice of supervising others.

- *Conversations with Leaders Speaker Series* which are leadership seminars for senior leadership designed to afford Federal Student Aid's senior leaders with a practical, meaningful and convenient way to engage in continuing leadership development.

- *New Employee Orientation* Program which is a half-day session for new hires that provides an overview of the federal student aid process, information about how we do business at Federal Student Aid and much more.

- *Federal Student Aid Data Analysis*--*Understanding the Customer's Need* which is a two-day course focused on identifying the customer's question, identifying the appropriate systems from which to retrieve appropriate information and using reports from Federal Student Aid systems to retrieve appropriate information.

In FY 2009, Federal Student Aid improved Human Capital Management by creating activities to address the issues raised in the 2008 Federal Human Capital Survey. Some examples of these activities include developing an initiative in response to the Best Places to Work data; working with colleagues across the Department in establishing measures and strategies for tracking leadership development; and coordinating our efforts with the Human Capital Advisory Committee; the Office of Personnel Management and other federal agencies.

**Objective 5: Improve products and services to provide better customer service.** In FY 2009, the President called for all Americans to seek at least one year of postsecondary education[5]. Federal Student Aid's response to this charge was to improve access to a college education by making the FAFSA easier to complete. Improvements to the 2010-11 Web version of the FAFSA facilitate a simpler experience for applicants. Applicants are never presented some questions or allowed to skip others due to enhanced skip logic and the expanded use of data provided early in the application. Federal Student Aid also began to coordinate with the Internal Revenue Service (IRS) to allow some applicants to import their tax form data into the FAFSA.

[5] http://www.whitehouse.gov/issues/education/

To increase awareness about the availability of student financial assistance, Federal Student Aid established a series of public service announcements via a nationwide campaign, which is one of the top-rated public service announcements in the country. The Federal Student Aid Ombudsman continued to provide a problem resolution resource for student borrowers.

Another priority of the new administration was to provide greater transparency in government. Federal Student Aid developed an online data center providing the public with access to information on loans, grants and campus-based aid.

## Quality of Performance Data

Federal Student Aid develops and uses performance data for various purposes. Facing opportunities provided by the budget and performance management processes and activity-based management, Federal Student Aid recognizes the need to improve the accuracy, reliability and completeness of its data. Although immediate connections between specific performance and funding levels are sometimes challenging to make, Federal Student Aid is improving systems to yield reliable performance data to make informed budget and policy decisions. These systems will enhance the budget process and increase the accuracy and reliability of the information received from FFEL and Direct Loan Program participants.

Federal Student Aid developed a matrix as guidance for data providers who have the responsibility for reporting data in performance measures to evaluate and identify issues of data integrity and credibility. The matrix provides a framework for validating and verifying performance data before it is collected and reported. The matrix was selectively implemented in FY 2008, expanded to include additional projects in FY 2009 and is used to evaluate data prior to publication.

The data validation criteria require that:

- The goal and measure are appropriate to the mission of the organization and measured performance has a direct relation to the goal.
- The goal and measure are realistic and measurable, achievable in the time frame established and challenging in their targets.
- The goal and measure are understandable to the lay person, language is unambiguous and terminology is adequately defined.
- The goal and measure are used in decision making about the effectiveness of the program and its benefit to the public.

The metrics employed to measure success are directly related to each of the objectives. As an example, targets for each of the metrics have been set at challenging, but realistic levels that are achievable within the time horizon.

We believe that the goals for each objective and the associated performance metrics and targets are understandable; however there are opportunities for improving the explanation of these relationships in future editions of our performance plans.

The Federal Student Aid Annual Report is published six weeks after the end of the fiscal year. Since a wide variety of data are submitted from diverse systems and governed by agreements with state guaranty agencies, lenders and servicers as well as grant and loan recipients, it is not possible in all cases to report complete data for the reporting period. In instances where fiscal year end data are not available, the most recently available data are presented. Effective decision making requires complete, accurate, timely and reliable data. Funding decisions are made and management actions are taken based on performance information. In addition to performance data received from the FFEL and Direct Loan Program participants, Federal Student Aid also deals with financial data. The data-quality processes for financial data are reflected in the financial statements and accompanying notes.

## Analysis of Federal Student Aid's Financial Statements

Federal Student Aid is committed to providing sound management, financial systems and controls to ensure that students receive aid and repay loans according to applicable laws and regulations. Federal Student Aid's financial statements are prepared in accordance with established federal accounting standards. The financial statements are subject to an annual independent audit to ensure that they are reliable and fairly present Federal Student Aid's financial position.

In FY 2009, Federal Student Aid achieved an unqualified audit opinion on its financial statements. The Independent Auditor's Report cited no material weaknesses in internal control.

For FY 2009 and FY 2008, the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position were prepared on a consolidated basis and the Statement of Budgetary Resources was prepared on a combined basis as required by the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. The Report of Independent Auditors (opinion) on these statements and accompanying Reports on Internal Control and Compliance with Laws and Regulations are included in this report.

Appropriations are available to cover the subsidy cost of each loan program and administrative expenses. Subsidy expense covers the difference between the net present value of expected future cash flows and the face value of each loan portfolio. Appropriation authority is available as needed on a permanent basis to finance costs resulting from loans guaranteed in the years before FY 1992. The Pell Grant Program receives appropriations to cover actual grant disbursements.

A comparison between significant line items reported in Federal Student Aid's FY 2009 and FY 2008 September financial statements is presented in the following table:

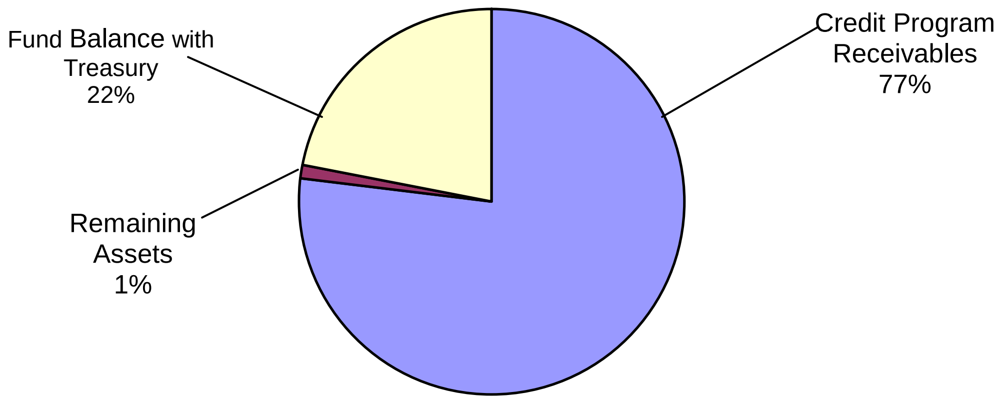
Summarized Financial Data – FY 2009 and FY 2008
(Dollars in Millions)

| | Percentage Change | Dollar Difference | FY 2009 | FY 2008 |
|---|---|---|---|---|
| Total Assets | 57.3% | $110,700 | $303,987 | $193,287 |
| Total Liabilities | 48.8% | $ 90,848 | $276,936 | $186,088 |
| Net Position | 275.8% | $ 19,852 | $ 27,051 | $ 7,199 |
| Net Cost of Operations | (173.7)% | $ (34,328) | $ (14,569) | $ 19,759 |

**The Balance Sheet**
**Composition of Federal Student Aid Assets**

The Consolidated Balance Sheet shows Federal Student Aid had total assets of $304.0 billion, as of September 30, 2009. This represents an increase of $110.7 billion over the previous year's total assets of $193.3 billion, as of September 30, 2008. The difference resulted primarily from an increase in the Credit Program Receivables and an increase in the various programs' Fund Balances with Treasury.

**Composition of Federal Student Aid Assets as of September 30, 2009**




Fund Balance with Treasury increased by $9.9 billion from September 30, 2008 to September 30, 2009. The FFEL fund balance increased primarily as a result of new borrowings used to support loan purchasing activities including the Loan Participation Purchase, the Loan Purchase Commitment and the ABCP Conduit Programs. Fund balances of the Direct Loan and Grants Programs increased to support the additional loan volume and grant activity. A new fund balance, the *Recovery Act,* was also a contributing factor in the increase in Fund Balance with Treasury. The *Recovery Act* fund balance is part of new funding used to support the increased grant activity of the Pell Grant and FWS Programs. Treasury processes Federal Student Aid's cash receipts, such as appropriation warrants, that provide cash for operations, and also processes loan payment collections received from students.

Credit Program Receivables, net of subsidy allowance, increased by $99.4 billion over the September 30, 2008 total. Credit Program Receivables are comprised of principal, interest and fees owed by students for Direct Loans, TEACH Grants, Perkins Loans, and FFEL loans under the Conduit, Loan Participation Purchase, Loan Purchase Commitment, and defaulted guaranteed loans. As of September 30, 2009, the balance was $234.0 billion in Credit Program Receivables – the majority of which were Direct Loan Program receivables, Loan Participation Purchase and Loan Purchase Commitment Programs and defaulted FFEL loans receivables.

Receivables, net of the allowance for subsidy, increased primarily due to two factors. As a result of the liquidity crisis in the financial markets, there has been a large influx of schools and participants into the Direct Loan Program, resulting in a significant increase in new loan originations. Also, the implementation of the Loan Participation Purchase and Loan Purchase Commitment Programs in FY 2008, as well as the implementation of the ABCP Conduit Program in FY 2009, allowed Federal Student Aid to purchase existing loans from the FFEL community.

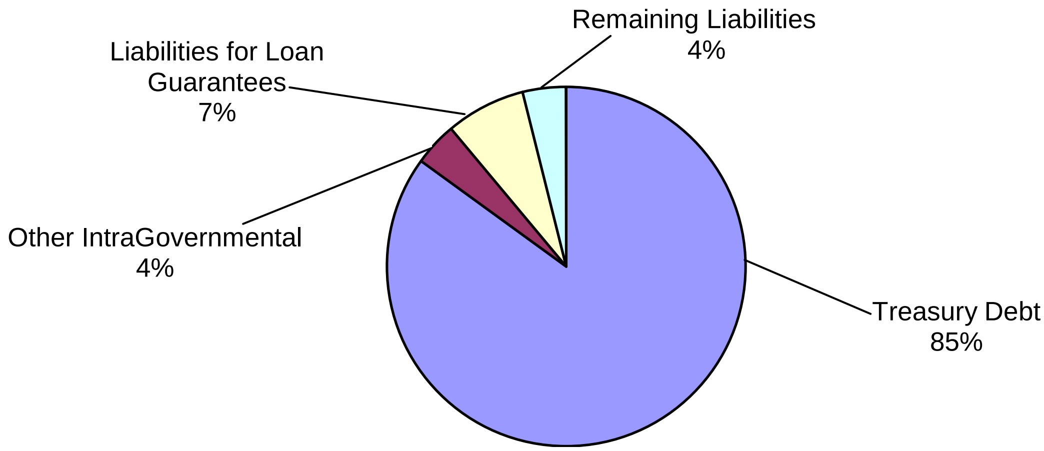
Receivables of defaulted guaranteed FFEL Program loans, net of allowance for subsidy, increased as a result of continued growth in the average amount of loans, growth in online schools, economic hardship and the expiration of both the Exceptional Performer designation and the Voluntary Flexible Agreements. Receivables of defaulted Direct Loans, net of allowance for subsidy, increased as a result of continued growth in the average amount of loans, growth in online schools and economic hardship.

**Composition of Federal Student Aid Liabilities**

Federal Student Aid had total liabilities, as of September 30, 2009, of $276.9 billion, an increase of $90.8 billion over the previous year's total liabilities. The difference resulted primarily from an increase in Debt due to Treasury and Other Intragovernmental Liabilities offset by a decrease in the Liabilities for Loan Guarantees.

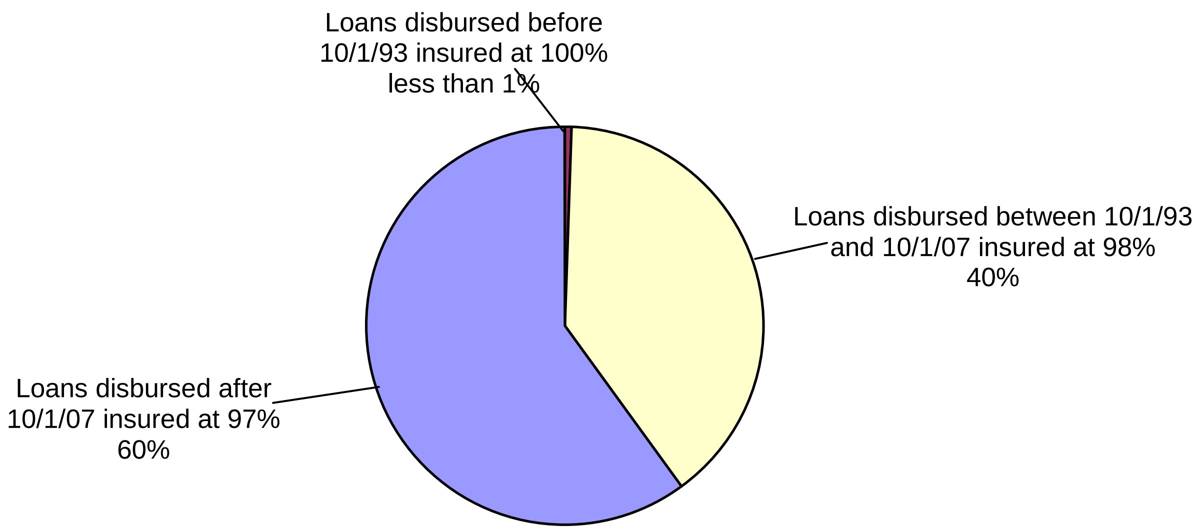
Debt increased as a result of the new borrowings to support the increased loan volume in the Direct Loan Program and new debt for the Loan Participation Purchase, Loan Purchase Commitment and ABCP Conduit Programs. Other Intragovernmental Liabilities increased as a result of the downward FFEL re-estimates and modifications of subsidy. Net subsidy-related transactions resulted in a reduction of the Liability for Loan Guarantees.

**Composition of Federal Student Aid Liabilities as of September 30, 2009**



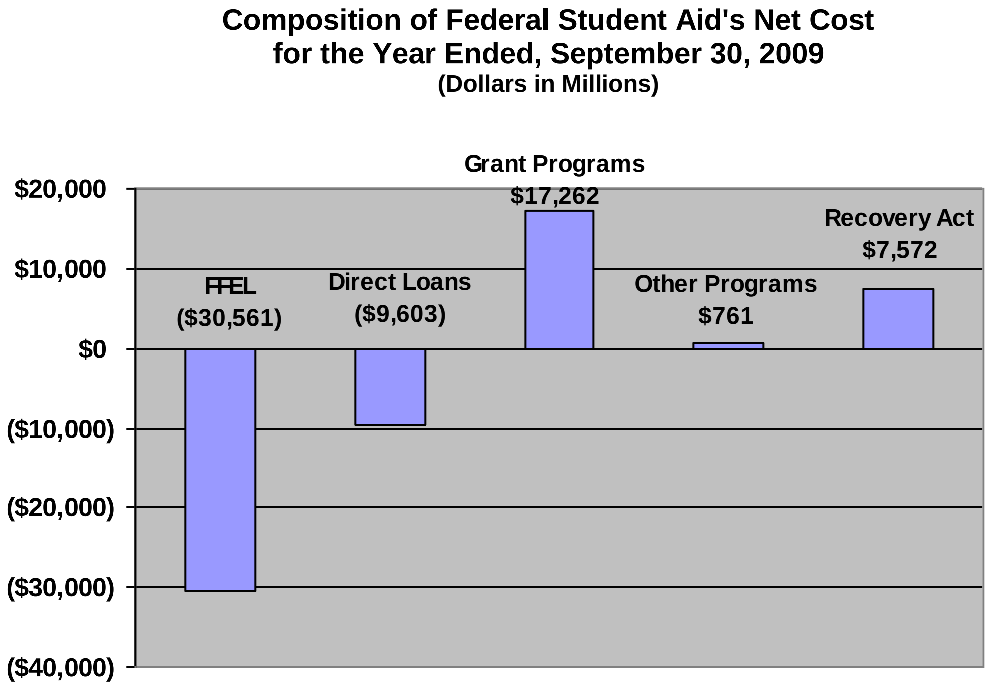
Total principal balances outstanding of guaranteed loans held by lenders were approximately $457 billion as of September 30, 2009, with a maximum government exposure of $445 billion. As illustrated below, of the insured amount, the Department would pay a smaller amount to the guaranty agencies in reinsurance rates, based on the age of the loan, which range from 100 to 95 percent.

**Estimated Maximum Government Exposure for Guaranteed Loans as of September 30, 2009**




**Statement of Net Cost**

Through September 30, 2009, net costs reflected a decrease of $34.3 billion from the previous year's total net cost of $19.8 billion. This included a significant decrease in net costs for the Direct Loan and FFEL Programs, netted against an increase in the Grant Programs, the *Recovery Act* and Other Programs*.* The gross costs are primarily composed of subsidy expenses from re-estimates and the funding of grants, under the Pell Grant Program and the *Recovery Act.* Subsidy expenses are the estimated costs of funding the direct loans and loan guarantees. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.




### Statement of Changes in Net Position

Federal Student Aid's net position as of September 30, 2009, was $27.1 billion, an increase of $19.9 billion over the previous year's total net position of $7.2 billion. The difference is primarily due to subsidy re-estimates and the unexpended appropriations for the *Recovery Act.*

### Statement of Budgetary Resources

The Statement of Budgetary Resources compares the budgetary resources provided with the status or execution of those resources and details the composition of the resources and the status of the resources and shows the amount of net outlays. This statement shows that Federal Student Aid had $313.2 billion in combined budgetary resources, of which $12.3 billion remained unobligated and not available.

Federal Student Aid had total net outlays as of September 30, 2009, of $105.7 billion. There was an increase in total net outlays of $60.0 billion comparing September 2009 to September 2008. Net outlays increased primarily due to the Secretary's authority, provided recently by ECASLA, to purchase FFEL Loans with a moderate increase for Direct Loans.

Gross outlays for Federal Student Aid increased $97.8 billion comparing September 2009 to September 2008 due to increased loan originations and consolidations in the Direct Loan Program and increased activity in the FFEL Loan Participation Purchase and Loan Purchase Commitment Programs. Offsetting receipts increased primarily due to the collection of subsidy re-estimates and modifications.

## Analysis of Federal Student Aid's Systems, Controls and Legal Compliance

Internal control is a major part of managing an organization. It comprises the plans, methods and procedures that are used to meet the missions, goals and objectives and, in doing so, supports performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources.

Internal control should provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations, including the use of the entity's resources.
- Reliability of financial reporting, including reports on budget execution, financial statements and other reports for internal and external use.
- Compliance with applicable laws and regulations.[6]

Federal Student Aid management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of *Federal Managers' Financial Integrity Act of 1982* (*FMFIA*). Federal Student Aid conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, Federal Student Aid reported to the Department's management that its internal control over the effectiveness and efficiency of its operations and compliance with applicable laws and regulations, as of September 30, 2009, were operating effectively.

In addition, Federal Student Aid, working with the Department's management, conducted its current year assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123, *Management's Responsibility for Internal Control*. The scope of Federal Student Aid's assessment included the following processes that impact the Department's financial statements:

[6] Government Accountability Office (GAO) Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1, November 1999, p. 4-5

- ABCP Conduit Program.
- ACG Program Operations.
- Campus-Based Program Operations.
- Debt Collection.
- Direct Loans – Consolidations.
- Direct Loan Operations.
- Direct Loans – Servicing.
- FFEL Servicing.
- Financial Partner Invoicing.
- Financial Partner Oversight.
- Financial Reporting.
- IT/General Computer Controls (Financial Management System, Common Origination and Disbursement System, Direct Loan Consolidation System, Direct Loan Servicing System, DMCS, National Student Loan Data System (NSLDS), Electronic Campus Based System, FFEL Reinstatement System, Conditional Discharge and Disability Tracking System).
- Loan Participation Purchase Program.
- Loan Purchase Commitment Program.
- Pell Grant Program Operations.
- Portfolio Performance Division Operations.
- School Eligibility Channel.
- SMART Grant Program Operations.
- Student Eligibility.
- TEACH Grant Program Operations.

Based on the results of this evaluation, Federal Student Aid provided reasonable assurance to the Department's management that its internal control over financial reporting as of June 30, 2009 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Federal Student Aid's participation in the Department's successful implementation of the requirements of OMB Circular A-123, Appendix A, enables it to continue to build upon its internal control framework. This framework will be used in continuing efforts to monitor and improve internal control.

Please refer to the Department's Agency Financial Report (AFR) for information related to the Department's compliance with the *Federal Financial Management Improvement Act of 1996*.

## Possible Future Effects of Existing Events and Conditions

Federal Student Aid's ability to fully implement the initiatives described in this report is impacted by external factors, including budget and policy considerations and unanticipated events. Federal Student Aid works closely with the Department and OMB to develop the administrative budget and ensure appropriate resources are allocated to support our strategic objectives. Legislative and/or regulatory action may result in policy, resources or program changes requiring Federal Student Aid to revisit our current strategic plan. Specifically, staff worked to implement the changes resulting from the passage of the *Higher Education Opportunity Act of 2008 (HEOA)*. As a result, Federal Student Aid will revise both the Annual Performance Plan and the Five-Year Plan to meet the new legislative and/or regulatory requirements.

In addition to the Loan Purchase Programs of FY 2008, the Secretary announced that the Department would provide liquidity support to one or more conforming Conduits in FY 2009. These special purpose entities would be established to purchase interests in eligible federal student loans currently residing on lenders' balance sheets and originally awarded between October 2003 and September 2009. This would provide lenders with liquidity to provide new loans for the coming academic year. The Conduit first issued commercial paper in May 2009 and as of September 30, 2009, $29.9 billion had been issued.

In February 2009, President Obama signed the *Recovery Act* into law. The *Recovery Act* provides an additional $17 billion for Pell Grants in FY 2009 and FY 2010; the current year funding is $16.2 billion, with 6.1 million students participating. In addition to increases in the *CCRAA*, the *Recovery Act* increased the maximum Pell Grant award to $5,350 in the first year and more in the second year. The *Recovery Act* also increased FWS by $200 million.

Other external factors could also affect our ability to achieve the organization's objectives. With ECASLA expiring in 2010 and lenders' continued participation in FFEL uncertain, Federal Student Aid has shifted focus to ensure that schools are able to easily transition into the Direct Loan Program. If the President's FY 2010 budget proposals are enacted, the expansion of the Perkins Loan Program will require a commitment of internal resources.

We are unable to anticipate the full impact of Federal Student Aid's ability to achieve its strategic objectives included in the Five-Year Plan as a result of a long-term commitment to other similar unforeseen events.

## Limitations of Financial Statements

Management has prepared the accompanying financial statements to report the financial position and operational results for Federal Student Aid, for FY 2009 and FY 2008 pursuant to the requirements of title 31 of the United States Code (U.S.C.), section 3515(b).

While these statements have been prepared from the books and records of Federal Student Aid in accordance with generally accepted accounting principles for federal entities and the formats prescribed by OMB, these statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and ongoing operations are subject to the enactment of future appropriations.

# Annual Program Performance Report

## Annual Program Performance

During FY 2009, Federal Student Aid achieved significant accomplishments especially considering several unanticipated events that caused a reassessment of priorities. The information presented herein provides details of our achievements, by objective. Under each objective below, we have identified the corresponding Performance Standard, as well as the organization's progress in meeting the stated target. A matrix providing information on the data quality and analysis of progress is also presented under each objective. Unless otherwise noted, these performance standards and their respective ratings are based on criteria established by Federal Student Aid.

The Performance Results for each Objective are presented in tables that provide trend data including the latest available reported data. The Performance Column shows the relationship between the new and actual values and targets as follows:

- "Met" represents that performance results met or exceeded the target.
- "Not met" represents that performance results fell short of the target.
- "Improved" represents that the performance results improved over the prior year but fell short of the target.
- "PM" represents that the measured performance, standards and/or targets were not established.
- "T" represents that the measure was replaced or discontinued.
- "NA" represents that the data is not available.

An analysis of progress is provided as insight into Federal Student Aid's progress. Data quality incorporates information such as the universe included in the measure while target context explains the parameters or rationale or the targets.

The Goals, Objectives and Results presented in this report terminated effective September 30, 2009. They will be replaced based on the new FY 2010 – 2014 Five-Year Strategic Plan. Some items may be similar with new targets identified.

### Objective 1: Integrate Federal Student Aid systems and provide new technology solutions.

In FY 2009, Federal Student Aid continued its focus on integration initiatives designed to improve accuracy and availability of the most critical information maintained throughout the financial aid lifecycle, specifically borrower, school and financial partner data. These initiatives are coordinated to present a more integrated and thus holistic view of borrower information to a variety of stakeholders within Federal Student Aid and the financial aid community. In FY 2009, Federal Student Aid established a Comprehensive Security Program to respond to the increasing need to provide additional protection of our data and oversight and monitoring of our systems. Federal Student Aid continued to establish the components of our new procurement and management approach to business application development.

Specifically, in FY 2009, Federal Student Aid:

- Completed planning to initiate the NSLDS re-engineering project, which improves the management and monitoring of borrowers' financial aid history. Federal Student Aid also established formal high-level requirements to begin the development of the NSLDS re-engineering project.
- Continued the Person Record Management System and Personal Identification Number Reengineering (PRMS/PIN-R) project to consolidate and manage borrower information in one location with a single, secure login process.
- Expanded the Enterprise Development Support Services (EDSS) Project and Program Management (P/PM) Model by prequalifying and approving four vendors' bids to receive future projects. As a result, Federal Student Aid reduces redundancy and disparate development and operations approaches, procedures and outputs.
- Completed project evaluation and awarded a contract to finalize project requirements and to develop a functional design for the IPM System, which will replace aging legacy systems and improve employee efficiencies and system response times.
- Implemented Enterprise Information Services which profiles, cleanses, integrates and delivers trusted information from heterogeneous sources to drive greater business insight faster, at a lower cost.
- Built out the Enterprise Portal Infrastructure and implemented the New Employee View on the Internet.
- Developed Federal Student Aid technology standards and technical standards for all Federal Student Aid IT infrastructures and made them available for key initiatives including the PRMS/PIN-R; NSLDS re-engineering; and Integrated Student View.
- Integrated Central Processing System (CPS)-Financial Aid Administrator (FAA) online application with the Enterprise Access and Identity Management system, a security authentication service to over 25,000 FAA users of CPS, without the need to use Personally Identifiable Information to access CPS-FAA online.
- Initiated a requirements solicitation project for Integrated Student View, which will support detailed requirements to be developed in the future.
- Improved the cyber security program through the establishment of Continuous Monitoring/Independent Verification and Validation program. Continued development of the Operational Vulnerability Management Solution used for capturing and managing identified information security and privacy weaknesses.

## Performance Standards and Results

*The following performance standards were established to measure Federal Student Aid's success in achieving key integration initiatives. Success is predicated on the timely completion of all scheduled project deliverables in the design, development and implementation phases of the four main systems integration initiatives as described below.*

## Objective 1 Performance Metrics and Results

| Metric | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 (Target) | FY 2009 (Actual) | Performance |
|---|---|---|---|---|---|---|---|
| IPM | * | Design | In develop-ment | Development terminated. New approach and timeline developed. | Complete evaluation and inventory to determine usability of current requirements and development by 1/31/09; develop a statement of objectives for re-starting IPM development by 6/30/09; issue request for proposal to re-start IPM development by 9/30/09. | Completed evaluation and inventory to determine usability of current requirements and development by 1/31/09; awarded contract on 9/25/09 to complete requirements and functional design. | Not met |
| Integrate aid delivery systems | * | * | Strategies completed | Issued request for information with a draft statement of work for person data management. High level planning completed. | Develop phase I requirements for NSLDS redesign by 8/30/09; develop requirements for PRMS/PIN by 9/30/09; Develop requirements for DMCS by 8/30/09. | High Level Requirements were developed for NSLDS redesign and used to make an award for design and build of phase I of the NSLDS reengineering project.<br><br>High level requirements were drafted for DMCS and used to issue a sources sought possible vendors. A contract was also awarded to form more detailed requirements to issue a request for proposal in FY 2010 for a collections services contract. | Met** |
| Acquisition strategy | * | * | Approach and timeline completed | Developer pool established. Customer care not complete. | Additional loan servicing vendors established; EDSS - P/PM vehicle established; EDSS requirements vehicle solicitation published; EDSS testing vehicle solicitation published. | Additional loan servicing vendors established; EDSS P/PM vehicle established; EDSS requirements vehicle solicitation published; EDSS testing vehicle solicitation published. | Met |
| Infrastructure | * | * | Phase 1 completed | Deployed enterprise portal infrastructure Enterprise Services Bus (ESB). | Work with development initiatives to establish plan for integration with portal and ESB as appropriate. | Worked with development initiatives to establish plan for integration with portal and ESB as appropriate. | Met |

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

**In June 2009, the target for DMCS was updated to reflect that the procurement was changed from having a new system built to a procurement for a service. The original schedule to do all requirements and produce a system was estimated at 24 months. In procuring a service, as a replacement to the default processes, we are expecting to be fully operational by the end of 2010.

**Data Quality:** Deliverables were achieved upon the completion of the prescribed phases of the corresponding projects.

**Analysis of Progress:** As we reported in the FY 2008 Annual Report, while the objectives of several of Federal Student Aid's integration projects remain the same, the development and procurement strategies for them changed. Federal Student Aid discovered that large contracts requiring multiple business capabilities and supporting a complex and multi-faceted business process, do not provide Federal Student Aid the best solution providers from the marketplace. In addition, the lack of post-award competition led to price, quality and innovation issues, preventing Federal Student Aid from being able to quickly transition services, potentially putting our business at risk.

**Target Context**: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the FY 2006 and the FY 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets, where developed, were not generally published. In this report, Federal Student Aid will report its progress primarily against FY 2009 targets that until now may not have been previously published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

### Objective 2: Improve program integrity to facilitate access to postsecondary education, while reducing the vulnerability of the federal student financial assistance programs to fraud, waste, abuse and mismanagement.

In FY 2009, Federal Student Aid improved its oversight of schools by partnering with and utilizing the data of other federal agencies that have monitoring responsibilities of postsecondary institutions such as the FBI. For example, Federal Student Aid began conducting joint campus security site visits with the FBI to improve monitoring of schools. Federal Student Aid enhanced program review standards to strengthen monitoring of distance education programs. We continued process improvement for monitoring the financial performance of publicly-traded schools and large school groups. Additionally, Federal Student Aid continued to effectively monitor lenders, guaranty agencies and servicers that participate in the FFEL Program. During FY 2009, Federal Student Aid focused its efforts in several areas including 9.5 percent SAP, implementation of the *ECASLA* programs and other focused risk areas, such as conflict of interest, consolidation loan rebate fees, existing lender and ELT relationships.

Specifically, in FY 2009, Federal Student Aid:

- Processed 99.7 percent of school compliance audits and 99.8 percent of school financial statements on time.
- Completed risk assessment for postsecondary schools. The data from the assessment resulted in:
    - Continued process improvement for monitoring the financial performance of publicly-traded schools and large school groups under common ownership;
    - Enhanced program review standards to strengthen monitoring of distance education program offerings; and
    - Developed a Direct Loan work group to identify potential risks associated with all new federal student loan originations going through the Direct Loan Program.
- Partnered with the Federal Trade Commission to leverage use of their monitoring tools for postsecondary institutions.
- Established a Clery Act Oversight Team with the FBI Criminal Justice Information Services staff and conducted nine joint institutional Clery Act reviews.
- Developed core competencies for FFEL Program review staff and implemented a mandatory training program.
- Resolved and closed the FY 2008 *FMFIA* Reportable Condition related to FFEL Oversight.
- Developed and implemented financial institution (lenders, guarantors and servicers) audit resolution standards to ensure consistency, accuracy and timeliness of the audit resolution process.
- Continued the monitoring of the 9.5 percent SAP portfolio. As a result of the application of the audit methodology, the 9.5 percent SAP qualified ending principal balance is $1.3 billion, representing an 88 percent decrease from the September 2006 ending principal balance of $11 billion.
- Conducted targeted FFEL oversight in such areas as conflict of interest, consolidation loan rebate fees, exiting lenders and ELT relationships.
- Processed 300 compliance audits of financial institutions and also reviewed over 100 audits related to the ECASLA Programs.
- Worked closely with the Department's Office of Inspector General to develop audit guides to improve oversight and monitoring of financial institutions participating in the Loan Purchase Programs authorized under *ECASLA*.

### Performance Standards and Results

*The following performance standards were established to gauge Federal Student Aid's success in improving program integrity, while reducing the vulnerability of the Title IV programs to fraud, waste and abuse. The success relies on continuing to achieve low default rates and increasing the recovery rate.*

### Objective 2 Performance Metrics and Results

| Metric | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 (Target) | FY 2009 (Actual) | Performance |
|---|---|---|---|---|---|---|---|
| PMA status score for financial management | Green | Green | Green | Green | T | Measure discontinued | T |
| PMA score for improper payments | Red | Yellow | Yellow | Yellow | T | Measure discontinued | T |
| CLTDR*** Title IV student loan portfolio | FY 2003 5.5%<br>FY 2002 7.8%<br>FY 2001 9.9%<br>FY 2000 11.8%<br>FY 1999 12.2% | FY 2004 5.9%<br>FY 2003 7.3%<br>FY 2002 9.2%<br>FY 2001 10.9%<br>FY 2000 12.7% | FY 2005 5.5%<br>FY 2004 8.0%<br>FY 2003 8.8%<br>FY 2002 10.3%<br>FY 2001 11.9% | FY 2006 5.8%<br>FY 2005 7.4%<br>FY 2004 9.5%<br>FY 2003 10.0%<br>FY 2002 11.3% | PM | FY 2007 8.0%<br>FY 2006 7.6%<br>FY 2005 8.6%<br>FY 2004 10.6%<br>FY 2003 10.9% | PM |
| CDR** | FY 2003 4.5% | FY 2004 5.1% | FY 2005 4.6% | FY 2006 5.2% | FY 2007 <6.0% | FY 2007 6.7% | Not met |
| Direct Loan default recovery rate | * | 19.0% | 20.1% | 21.0% | 20.0% | 18.0% | Not met |
| FFEL default recovery rate | * | 19.4% | 19.6% | 23.6% | 19.75% | 19.70% | Not met |

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.
**Indicates what year the data was reported. For example, during FY 2009, Federal Student Aid calculated the FY 2007 CDR.
***The CLTDR was first published in FY 2006. Since that time, Federal Student Aid has produced and published the FY 2005, FY 2006, FY 2007 and FY 2008 calculations for the relevant preceding five-year periods, respectively. Federal Student Aid will continue to analyze the impact of portfolio performance on the CLTDR before identifying future performance targets.

**Data Quality:** Indicates what year the data was reported. For example, during FY 2009, Federal Student Aid calculated the FY 2007 CDR.

**Analysis of Progress**: Federal Student Aid continues to make progress in improving program integrity as defined by the identified performance standards above. The FFEL target was hampered by the economic conditions and the inability of the guaranty agencies to sell all of their rehabilitated loans. Had they been able to sell their loans, they would have exceeded their goal.

**Target Context:** In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the FY 2006 and the FY 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets, while developed, were not generally published. In this report, Federal Student Aid will report its progress primarily against FY 2009 targets that until now may not have been previously published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

### Objective 3: Reduce program administration costs.

Federal Student Aid continued to focus on reducing costs through efficiency and productivity gains that can be achieved throughout the organization. In FY 2009, Federal Student Aid experienced significant increases in workload volumes across several Federal Student Aid programs and processes. This included an increase of approximately 22 percent in applications processed, an increase of 42 percent[7] in the number of schools originating loans in the Direct Loan Program and an increase of 26 percent[8] in Pell Grants disbursed. We anticipate these and other workload volumes will continue to increase in the coming years, driving down unit costs but increasing gross costs. In the future, we will look at a more balanced approach to cost management to ensure a "best value" proposition to the government and our customers. This approach will consider several variables to gauge cost management including measurement of unit cost and the relative impact of unit cost fluctuations on programmatic and systemic risk as well as customer service levels, among others.

Specifically, in FY 2009, Federal Student Aid:

- Reduced the projected unit cost to service federal student loans owned by the Department, as a result of the award of student loan servicing contracts to four private sector servicers. The unit cost to service federal student loans will decrease if the portfolio of federal student loans held by the Department increases as projected.
- Issued a new competitive contract for NSLDS Operations and Maintenance Services, thereby saving Federal Student Aid approximately three percent annually beginning in FY 2009. These savings will continue through FY 2013.
- Saved over $2.0 million dollars through the renegotiation of software licensing and maintenance agreements in FY 2009. These same agreements will save Federal Student Aid an additional $2.0 million annually through FY 2011 and $1.5 million annually in FY 2012 and FY 2013.
- Re-competed a contract for operational, maintenance and development support services for the Financial Management System application. The new 10-year contract was awarded to a small business concern resulting in a cost savings of approximately $1.3 million per annum.
- Consolidated Federal Student Aid's two fall training conferences to a single event, saving the Department approximately $160,000 on an annual basis.
- Continued the monitoring of the 9.5 percent SAP portfolio. As a result of the application of the audit methodology, the 9.5 percent SAP qualified ending principal balance is $1.3 billion, representing an 88 percent decrease from the September 2006 ending principal balance of $11 billion.

---

[7] Represents the increase between the 2007-08 award year and the 2008-09 award year.
[8] Represents the increase between the 2007-08 award year and the 2008-09 award year.

- Deobligated $43.5 million as a result of contract closeout efforts in FY 2009. Of that amount, the majority was reapportioned for use on other priorities and the remaining amount was returned to Treasury.

**Performance Standards and Results**

*Performance standards were established to measure Federal Student Aid's ability to control costs in an environment of increasing workloads. Success relies on achieving economies of scale in our application, delivery, servicing and collection activities.*

**Objective 3 Performance Metrics and Results**

| Metric | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 (Target) | FY 2009 (Actual) | Performance |
|---|---|---|---|---|---|---|---|
| Reduce electronic FAFSA direct unit cost | * | $ 5.04 | $ 4.34 | $ 3.91 | $ 4.03 | $ 3.94 | Met |
| Reduce origination and disbursement direct unit cost | * | $ 4.42 | $ 4.03 | $ 3.65 | $ 3.98 | $ 3.60 | Met |
| Reduce Direct Loan servicing direct unit cost | * | $20.95 | $21.45 | $19.59 | $18.44 | $19.25 | Improved |
| Reduce collections direct unit cost | * | $ 0.14 | $ 0.13 | $ 0.14 | $ 0.12 | $ 0.13 | Improved |

* Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

**Data Quality:** Unit costs are based on prior year data. For example, in FY 2009, the unit costs were based on data from FY 2008. To calculate the unit cost of Originating and Disbursing Direct Loans and Pell Grants, the total amount spent on originating and disbursing Direct Loans and Grants is divided by the total number of Direct Loan and Grant disbursements. For 'Processing an Electronic FAFSA', 'Servicing a Direct Loan Borrower' and 'Collecting One Dollar in Default Status' the total amount spent for each output is divided by the number of units for the output.

**Analysis of Progress**: Federal Student Aid has made significant progress in its efforts to reduce the administrative unit costs. All measures are equal to or below the baseline amounts from FY 2006. Due to the nature of the cost calculation for default collections, it will be difficult to meet the target of $0.12. This is due to the fact that this measure includes the costs for Private Collection Agency contracts, which increase in cost as the amount collected increases. While the unit cost of collecting one dollar in default is relatively steady, the actual amount collected has increased since the FY 2006 baseline. We plan to reevaluate this standard when we produce the next Five-Year Plan.

Also, while Federal Student Aid did not realize any significant savings based on the budget request for any new major system initiative projects during FY 2009, as noted in the accomplishments in this objective, it did re-compete a contract for operational, maintenance and development support services for the Financial Management System application. The new 10-year contract was awarded to a small business concern resulting in a cost savings of approximately $1.3 million per annum. In addition, during FY 2008, a major capacity upgrade was made to the Department's Common Origination and Disbursement System which manages the origination and disbursement process for the Direct Loan Program as well as many federal grant programs. Federal Student Aid continued upgrades to these systems in 2009 with two additional smaller but significant upgrades. In June, several servicing contracts were awarded to private sector servicing firms to increase the Department's student loan servicing capacity to improve service to students and reduce borrower defaults. This servicing capacity was operational by September 1. While no savings have been realized to date, future unit cost savings are expected.

In addition, we anticipate workload volumes to continue to increase in the coming years, driving down unit costs but increasing gross costs.

**Target Context**: In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the FY 2006 and the FY 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets, where developed, were not generally published. In this report, Federal Student Aid will report its progress primarily against FY 2009 targets that until now may not have been previously published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives. Targets were set in the FY 2006 – 2010 Five-Year Plan. The targets are based on reductions from the baseline set in FY 2006.

### Objective 4: Improve human capital management.

Human capital management is a critical component of Federal Student Aid's current business operations and future initiatives. Federal Student Aid continues to grow as an organization that empowers individuals to perform at a high level of effectiveness and efficiency. Federal Student Aid is utilizing innovative hiring and employee development techniques aimed at attracting and retaining highly qualified individuals to create a more productive, results-oriented workforce. Additionally, the organization is committed to workforce development and training to ensure a skilled and highly qualified professional workforce.

In FY 2009, Federal Student Aid began to develop and implement a succession strategy to "build leaders at all levels." Federal Student Aid initiated a hiring freeze beginning July 1, 2008 and slowly began hiring new staff in March 2009. The organization dedicated itself to training the workforce in the fundamentals of its business and other mission-critical areas, building strong current and future leaders and aligning staff in effective organization structures. Some examples of training courses include:

- *Cornerstones of Supervision* which is a 35-hour supervisory skill-building program to develop individual assessments through group discussion and exercises focusing on the art and practice of supervising others.

- *Conversations with Leaders Speaker Series* which are seminars for senior managers with a practical, meaningful and convenient way to engage in continuing leadership development.

- *New Employee Orientation Program* which is a half-day session for new hires that provides an overview of the federal student aid process, information about how we do business at Federal Student Aid.

- *Federal Student Aid Data Analysis--Understanding the Customer's Need* which is a two-day course focused on identifying the needs of the customer and identifying how to best address and respond to those needs.

In FY 2009, Federal Student Aid improved Human Capital Management by creating activities to address the issues raised in the 2008 Federal Human Capital Survey. Some examples of these activities include developing an initiative in response to the Best Places to Work data; working with colleagues across the Department in establishing measures and strategies for tracking leadership development; and coordinating our efforts with the Human Capital Advisory Committee; the Office of Personnel Management and other federal agencies.

**Performance Standards and Results**
*The performance standard for improving human capital management measures Federal Student Aid's ability to maintain a skilled and knowledgeable workforce. Specifically, the performance measures will identify our mission-critical competencies, identify where current or potential weaknesses exist and identify training plans for individuals to further develop competency/skills/knowledge.*

## Objective 4 Performance Metrics and Results

| Metric | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 (Target) | FY 2009 (Actual) | Performance |
|---|---|---|---|---|---|---|---|
| Use training resources to develop a highly skilled workforce to ensure competency in mission-critical skills/knowledge | * | Leadership: trained 100% of new supervisors and 52% of current supervisors | Leadership: trained 95% of new supervisors and 60% of current supervisors | Leadership: trained 96% of new and 96% of current supervisors | Leadership: train 95% of new and 70% of current supervisors | Leadership: trained 82% of new and 99% of current supervisors | Not met |
| | * | Acquisitions: trained 100% of contracting officials | Acquisitions: trained 100% of contracting officials | Acquisitions: trained 100% of contracting officials | Acquisitions: train 100% of contracting officials | Acquisitions: trained 100% of contracting officials | Met |
| | * | Project management: trained 100% of key IT project managers | Project management: trained 75% of key IT project managers | Project management: trained 67% of key IT managers | Project management: train 50% of key IT managers | Project management: trained 64% of Key IT managers | Met |
| | | Federal Student Aid business knowledge: trained 90% of new employees | Federal Student Aid business knowledge: trained 100% of new employees | Federal Student Aid business knowledge: train 89% of new employees | Federal Student Aid business knowledge: train 90% of new employees | Federal Student Aid business knowledge: trained 53% of new employees | Not met |
| | * | Federal Student Aid business knowledge: trained 100% of school compliance officials | Federal Student Aid business knowledge: Trained 100% of school compliance officials | Federal Student Aid business knowledge: Trained 76% of school compliance officials | Federal Student Aid business knowledge: Train 80% of school compliance officials | Federal Student Aid business knowledge: trained 77% of school compliance officials | Not met |
| | | Federal Student Aid business knowledge: trained 40% of general workforce | Federal Student Aid business knowledge: trained 100% of general workforce | Federal Student Aid business knowledge: train 34% of general workforce | Federal Student Aid business knowledge: train 40% of general workforce | Federal Student Aid business knowledge: trained 39% of general workforce | Not met |

*Data is not available because 1) the Department was not collecting this data during the fiscal year indicated, 2) the project did not exist or 3) the performance standard had not been established.

**Data Quality**: Data was obtained from training class rosters and attendance records.

**Analysis of Progress**: Leadership training of new supervisors did not reach our goal of 95 percent as two supervisors remain untrained; both untrained new supervisors were unable to schedule their training due to competing organizational priorities. One is currently scheduled for a session at the beginning of the new fiscal year. Targets for training current supervisors were met. Training for acquisitions and project managers were both met by third quarter. Results varied for the Federal Student Aid Business

Knowledge training targets. Federal Student Aid hired a large number of employees immediately preceding the end of the third quarter. These employees will receive new employee orientation training in FY 2010. The targets for school compliance officials, the general workforce and the data analysis workforce were not met this year. Scheduling and space constraints pushed the two remaining data analysis workforce regional offerings of the "Introduction to Data Analysis" course into October 2009.

**Target Context**: Federal Student Aid developed the above targets at the beginning of FY 2009 and immediately began tracking their progress in achieving these objectives.

### Objective 5: Improve products and services to provide better customer service.

In FY 2009, the President called for all Americans to seek at least one year of postsecondary education[9]. Federal Student Aid's response to this charge was to improve access to a college education by making the FAFSA easier to complete. Improvements to the 2010-11 web version of the FAFSA facilitate a simpler experience for applicants. Applicants are never presented some questions or allowed to skip others due to enhanced skip logic and the expanded use of data provided early in the application. Federal Student Aid also began to coordinate with the IRS to allow some applicants to import their tax form data into the FAFSA.

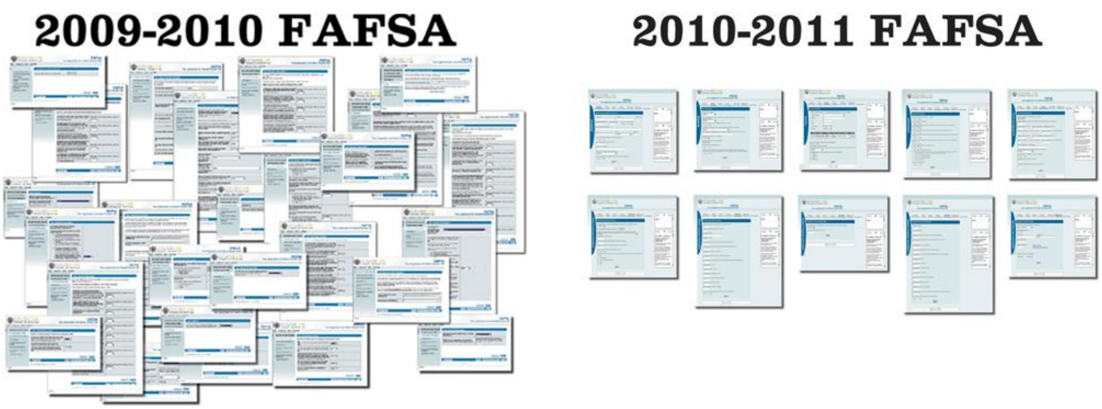
To increase greater awareness about the availability of student financial assistance, Federal Student Aid established a series of public service announcements via a nationwide campaign, resulting in one of the top-rated public service announcements in the country. The Federal Student Aid Ombudsman continued to provide a problem resolution resource for student borrowers.

Another priority of the new administration was to provide greater transparency in government. Federal Student Aid developed an online data center providing the public with access to information on loans, grants and campus-based aid.

[9] http://www.whitehouse.gov/issues/education/

Specifically, in FY 2009, Federal Student Aid:

- Simplified the aid application process by reducing the number of questions on the FAFSA for the current award year and reevaluated aid application procedures as part of a comprehensive, long-term strategy to simplify federal student aid eligibility determination. The differences in the prior and new versions of the FAFSA are illustrated below:




The charts above illustrate the initial results of Federal Student Aid's application simplification efforts. Specifically, the figures demonstrate the reduction in the number of screens that would be presented to an average borrower who completed the 2009-10 FAFSA and the 2010-11 FAFSA.

The student represented in the illustration above is a 17 year old female, a U.S. citizen, unemployed and plans to attend college in the fall. She receives reduced-priced lunch and lives with her parents, whose collective adjusted gross income is $45,000. In this case, she would be presented with 22 fewer questions and 20 fewer Web screens.

- Augmented both the FAFSA submission confirmation page and the Student Aid Report with federal student loan, Pell Grant and ACG eligibility determinations as well as information on relevant sources of federal, state and institutional aid.
- Reduced applicant burden by beginning an effort to electronically import income data fields on the FAFSA by initiating a joint project with the IRS. This will increase customer satisfaction with the application experience and increase program integrity by incorporating real-time verification of financial information into the aid application process.
- Launched the "I'm Going®" public service campaign in January 2009, resulting in approximately 70,000 television airings generating more than 930 million impressions worth an estimated $30 million and over 95,000 radio airings generating over 250 million impressions worth more than $11.8 million.
- Developed and launched http://www.opportunity.gov, in collaboration with the Department of Labor (DOL), to highlight educational opportunities and financial aid resources available to unemployed workers.
- Decreased by 17 percent the number of research cases open by the Federal Student Aid Ombudsman. The improved performance is attributed to a refined response protocol for online assistance requests, integrated case oversight and implementation of a referral system to connect defaulted borrowers with a designated Ombudsman contact at each private collection agency. In FY 2009, customer satisfaction with the Federal Student Aid Ombudsman, as measured through independently conducted telephone surveys, was 91 percent.

- Implemented the Income-Based Repayment Plan and developed an online calculator located on its student aid site to assist potential borrowers in determining their eligibility and to estimate if they would benefit from the plan.
- Developed several processes to improve information dissemination to our customers and stakeholders in accordance with the President's directive to increase transparency across the federal government. This included the launch of the Federal Student Aid Data Center providing a single online source for information and data on Federal Student Aid Programs and enhancement of *Freedom of Information Act* and *Privacy Act of 1974* operational processes, increasing the number of cases closed by approximately 40 percent and decreasing the average *Freedom of Information Act* case age by approximately 70 percent.
- Produced two new publications for students and their parents:
    - My Future, My Way: How to Go, How to Pay—an early awareness workbook http://studentaid.ed.gov/students/publications/my_future_my_way/index.html for middle and junior high school students; and
    - Your Federal Student Loans: Learn the Basics and Manage Your Debt—a booklet http://studentaid.ed.gov/repayingpub for student loan borrowers with information on the types of federal student loans, the difference between private and federal student loans, how much to borrow, tips on repaying loans successfully, the consequences of default and other helpful hints on how to manage student loan debt.

**Performance Standards and Results**

*The following performance standards were established to measure Federal Student Aid's success in meeting and exceeding customer service goals. Specifically, success is realized with continuous improvement in customer satisfaction scores for the three main systems.*

**Objective 5 Performance Metrics and Results**

| Metric | FY 2005 | FY 2006 | FY 2007 | FY 2008 | FY 2009 (Target*) | FY 2009 (Actual) | Performance |
|---|---|---|---|---|---|---|---|
| Student aid application | 81 | 80 | 80 | 83 | 84 | 84 | Met |
| Lender payment processing | 72 | 71 | 75 | 77 | PM | 74 | PM |
| Direct Loan borrower servicing | 76 | 79 | 80 | 80 | PM | 78 | PM |

**Data Quality:** The American Customer Satisfaction Index (ACSI) survey is conducted annually on Federal Student Aid's major programs. The index provides a national, cross-industry, cross-public and private sector economic indicator, using widely accepted methodologies to obtain standardized customer satisfaction information. Survey scores are indexed on a 100-point scale. This index has been tracked annually since FY 1999, with the exception of FY 2002.

**Analysis of Progress:** The FY 2009 ACSI ratings for Federal Student's highest volume products and services – including, FAFSA on the Web (FOTW®), Direct Loan Servicing and the Lender Reporting System – score in the "Excellent" or "Good" range in comparison to other entities that appear in the ACSI index. According to Claes Fornell International Group who partners with National Quality Research Center and the American Society for Quality in conducting the survey, companies with "business to business" customers scoring between 80 and 90 are considered "Excellent" and businesses with "business to consumer" customers scoring between 66 and 74 points on the index are considered "Good." Under the ASCI index, student aid application rated in the "Excellent" range while lender payment processing and direct loan servicing rated in the "Good" range.

**Target Context:** In the FY 2006 – 2010 Five-Year Plan, Federal Student Aid established and documented strategic performance standards to measure the organization's success in meeting the stated long-term objectives. In that plan, Federal Student Aid generally published the FY 2006 and the FY 2010 targets. Because Federal Student Aid has not updated that plan, interim year targets, where developed, were not generally published. In this report, Federal Student Aid will report its progress primarily against FY 2009 targets that until now may not have been previously published. All targets referenced in this report, whether previously published or not, are aligned with the FY 2010 targets and gauge Federal Student Aid's incremental progress in achieving its objectives.

### Major Obstacles

During FY 2009, Federal Student Aid was faced with many challenges as the organization worked to fulfill its mission and meet its strategic objectives. Most notably was the disruption to the credit markets and its impact on FFEL Program lenders. However, there were several other planned and unplanned obstacles that diverted much-needed human and capital resources from our central mission. The following is a brief summary of the major obstacles faced by Federal Student Aid in FY 2009.

**Loan Purchase Programs.** On May 7, 2008, President Bush signed the *ECASLA*. The legislation provided the Department with the authority to address concerns about the availability of FFEL Program loans for the upcoming academic year. *ECASLA* also increased annual and aggregate loan amounts in the FFEL and Direct Loan programs and provided relief for certain PLUS Loan borrowers whose adverse credit history is related to payments on home mortgages or medical bills.

In May 2008, based on the authority granted by *ECASLA*, the Secretary announced a comprehensive plan to ensure that all eligible students (and their parents) had access to federal student loans for the 2008–09 academic year. That plan included four key components:

1. An offer to purchase FFEL Program loans made for the 2008–09 academic year from lenders in order to offer lenders access to short-term liquidity;

2. A pledge to work with the student lending community on forward-looking solutions to ensure the FFEL Program and other student lending programs serve the best interests of students and taxpayers for years to come;

3. An enhanced lender-of-last-resort program designed to provide access to FFEL Program loans for those students who face difficulty obtaining conventional loans; and

4. A more efficient Direct Loan Program with increased capacity.

A key component of this plan was the development and implementation of two loan purchase programs to provide immediate liquidity to FFEL lenders.

1. Loan Participation Purchase Program – Under the Loan Participation Purchase Program, the Department offered to purchase through September 30, 2009, “participation interests” in pools of FFEL loans made for the 2008–09 academic year. By October 15, 2009, lenders must have either redeemed those loans or sold them outright to the Department.

   - Under this program, the lender pays the Department a yield on its participation interest calculated as the three-month commercial paper rate reported by the Federal Reserve in Publication H-15 plus 50 basis points on the principal amount of loans in which the Department purchased a participation interest.

2. Loan Purchase Commitment Program – Under the Loan Purchase Commitment Program, the Department offered to purchase eligible FFEL loans made for the 2008–09 academic year through October 15, 2009.

   - The Department’s purchase price is equal to the total of the (1) outstanding principal balance of the loan, plus (2) accrued interest, plus (3) a refund of the one percent lender origination fee paid to the Department on the amount disbursed, plus (4) $75 per loan.

The Department announced the extension of the final purchase date for loans originated in award year 2008-09 from September 30, 2009, to October 15, 2009. The obligation to purchase these loans was recorded in FY 2009. As of September 30, 2009, the Department had received $21.9 billion of notices of intent to purchase award year 2008-09 loans by October 15, 2009. As of October 15, 2009, lenders had requested and the Department purchased participation interests in pools of loans totaling $33.4 billion to date. In addition, lenders had requested the Department purchase outright approximately $48.5 billion in eligible 2008–09 loans through the 2008–09 Loan Purchase Commitment Program. Of these, approximately $31.3 billion or 64 percent of these loans were initially funded from the 2008–09 Participation Program. The $48.5 billion represents the gross amount the Department paid for the loans and includes accrued interest, $75 per loan and the rebate of the 1 percent origination fee. The corresponding net principal balance of loans sold to the Department was approximately $46.1 billion. This represents approximately 75 percent of the total 2008–09 FFEL disbursement volume.

**Replication of the Loan Purchase Programs for the 2009–10 Academic Year.** Under the initial programs, the Department purchased loans that had already been made by lenders, or participation interests in those loans on which the lenders had made at least a first disbursement. This required lenders to obtain short-term financing from private sources in order to make the loans. In addition, only 2008–09 loans would be eligible to be sold to the Department through these programs.

With more than $65 billion in 2007–08 loans and approximately $130 billion in eligible 2003–07 student loans on bank balance sheets and auction rate securitizations, the capital markets were unable to generate adequate funds at prices that would ensure 2009–10 loans could be made. As conditions in the credit markets continued to deteriorate, lenders were faced with a decision whether to commit to providing loans to schools for the coming academic year. The Department began hearing concerns from both the school and lender communities that assistance was needed to ensure 2009–10 loans would be available.

In October 2008, the President signed a one-year extension of authorities contained in *ECASLA*. In early November 2008, the Secretary announced a plan to ensure availability of federal student loans for the 2009–10 academic year by replicating the 2008–09 loan purchase programs for the 2009–10 academic year. Under the plan, the 2008–09 loan purchase programs would conclude as designed and the Department would offer the same programs, on substantially the same terms, for loans made for the 2009–10 academic year.

Results for the 2009-10 Loan Purchase Programs included:

- As of September 30, 2009, 28 lenders had entered into Master Participation Agreements with the Department for the 2009-10 academic year. The Department has, to date, purchased participation interests under these agreements totaling $7.9 billion.

- As of September 30, 2009, 36 lenders had entered into Master Loan Sale Agreements for the 2009-10 academic year with the Department. Two of these lenders have requested the Department purchase eligible loans in late October 2009 totaling $14.5 million dollars.

**Asset-Backed Commercial Paper Conduit.** In addition to the Loan Purchase and Loan Participation Purchase Programs, the Department has entered into a Put Agreement with a newly-created ABCP Conduit and agreed to enter into such agreements on the same terms with other conforming conduits.

Under a Conduit program, a special purpose entity (the Conduit) issues commercial paper to investors to finance its acquisition of interests in federally-reinsured student loans made between October 2003 and September 2009. The commercial paper is backed by the Conduit's interest in these loans. The Conduit uses proceeds of these sales to acquire these interests from lenders. Lenders that sell interests to the conduit must commit to provide new loans for the coming academic years with a portion of the proceeds of the sale. To ensure that the Conduit will have the resources to meet investor demands on maturing commercial paper if it is unable to reissue that paper or meet that demand from its own resources, the Department entered into a forward purchase commitment (a Put Agreement) with the Conduit, under which the Department agreed to purchase pledged loans from the Conduit at a prearranged price as and when needed to ensure that the Conduit can meet these demands of its investors. In addition, the Federal Financing Bank has entered into a Liquidity Loan Agreement with the Conduit to provide immediate advances as needed by the Conduit.

Results for the ABCP Conduit included:

- The Conduit first issued commercial paper in May 2009 and as of September 30, 2009, $29.9 billion was issued.

**Establishment of a Short-Term Loan Purchase Program for the 2007–08 Academic Year**. Until the time that the first Conduit became operational, lenders continued to struggle to obtain funds to make loans, in particular to make second disbursements when needed on loans for the 2008–09 academic year.

To address this need, in late November 2008, the Secretary announced that the Department would use its loan purchase authority to purchase certain 2007–08 academic year FFEL Program loans. This short-term use of the purchase authority was designed to prevent disruption in student lending prior to the ABCP Conduit becoming operational.

Under this program, the Department offered to buy FFEL Program loans disbursed between May 2007 and September 2008 for a loan period beginning on or including July 1, 2007. Under this program, the Department agreed to purchase up to $500 million in loans each week that the program was operational, at 97 percent of the balance owed on the loan. Lenders were required to use a portion of the proceeds of the sale to make new FFEL loans.

Results for the 2007-08 Short-term Loan Purchase Programs included:

- By February 25, 2009 the Department accepted final offers to purchase eligible loans under the 2007–08 Loan Purchase Commitment Program and by March 9, 2009 had completed those purchases. Under this program, the Department purchased loans totaling approximately $1 billion.

**Direct Loan Capacity.** As a result of the state of the credit markets and subsequent passage of the *ECASLA*, the Department prepared to acquire a large volume of federally guaranteed student loans. In addition, schools began to enroll and participate in the Direct Loan Program to ensure a stable source of loans for their students. In fact, the number of schools originating loans in the Direct Loan Program increased 42 percent between June 30, 2008 and June 30, 2009. Finally, the President's FY 2010 budget proposes originating all new federal student loans through the Direct Loan Program starting in FY 2010.

The Department invested considerable resources over the past 18 months to increase both the Direct Loan origination and servicing capacity. This was required primarily as a result of the disruption in the credit markets and the impact of that disruption on the FFEL Program. Last year, we completed a major capacity upgrade to the Department’s Common Origination and Disbursement System which manages the origination and disbursement process for the Direct Loan Program as well as many federal grant programs. In June, several servicing contracts were awarded to private sector servicing firms to increase the Department’s student loan servicing capacity to improve service to students and reduce borrower defaults. This servicing capacity was operational by September 1.

The selected contractors will service Direct Loans and FFEL loans being acquired by the Department under the ECSLA loan purchase programs. The award of these contracts provides the Department with the capacity necessary to support anticipated increases in the number of loans owned by the Department and ensures borrowers will receive the assistance they need to effectively manage their federal student loan obligations.

**FAFSA Simplification.** Part of the transition to a new administration includes implementing the President's priorities, one of which includes making a college education more accessible for Americans. To do this, the Secretary was charged with simplifying the FAFSA. Federal Student Aid designed and began to implement the changes necessary to achieve the President's goal. Federal Student Aid made a series of improvements to the online application. Although over 95 percent of students apply online, much of the online form simply reproduces the paper version rather than taking advantage of the interactive potential. On June 24, 2009, Secretary Duncan announced a shorter and simpler online application that skips unnecessary questions and provides students with instant estimates of Pell Grant and student loan eligibility, rather than requiring them to wait weeks. It also provides a link to more college information such as graduation rates. Federal Student Aid continues to work to provide a series of additional improvements that will be implemented in January 2010.

**Budgetary Impact.** Funding for student aid administration totaled $753 million for FY 2009. The FY 2009 administrative costs were significantly impacted by the administration's efforts to originate and service the increased Direct Loan volume, implement the loan purchase and participation initiatives authorized by the *ECASLA* and simplify the financial aid process. To fund these activities, the Department deferred planned projects and used a portion of the additional $60 million provided by the *Recovery Act*.

Due to the impact of ECASLA on Federal Student Aid's programs and major systems, no significant cost savings were realized in FY 2009 on major new system initiatives. As a result of the state of the credit markets and subsequent passage of the ECASLA, the Department prepared to acquire a large volume of federally guaranteed student loans. In addition, schools began to enroll and participate in the Direct Loan Program to ensure a stable source of loan capital for their students. In fact, schools originating loans in the Direct Loan Program increased 42 percent between June 30, 2008 and June 30, 2009. Finally, the President's FY 2010 budget proposes originating all new federal student loans through the Direct Loan Program starting in 2010.

In the wake of disruption in the credit markets, Federal Student Aid began increasing its origination and servicing capacity to ensure reliable access to federal student loans. During the year, Federal Student Aid increased tiers that provided reduced unit pricing in the Common Origination and Disbursement contract. On June 17, 2009, Secretary Duncan announced that four companies were awarded contracts to service loans for the Department. The award of these contracts provides the Department with the capacity necessary to support anticipated increases in the number of loans owned by the Department and ensures borrowers will receive the assistance they need to effectively manage their federal student loan obligations.

Given the structure of subsidies in the FFEL program, shifting more loans to the Direct Loan Program brings substantial budgetary savings to taxpayers.

## Performance Plan Items Reported as Incomplete or Canceled

Following is a summary of the items on the FY 2009 Performance Plan reported as incomplete or canceled as of September 30, 2009.

**FY 2009 Performance Plan**
**Projects Incomplete or Canceled as of September 30, 2009**

| Project Name and Number | Description |
|---|---|
| Complete Reorganization of Program Compliance *(Project 9.0)* | Canceled. The organizational changes that were approved in the first quarter of FY 2008 for Program Compliance were not feasible due to the delays with the development of the IPM Project. However, the primary objectives of the reorganization were achieved in alternative ways, (e.g. a focus on Clery reviews, publicly-traded schools, etc.) |
| Recompete IPM Solution *(Project 10.0)* | Incomplete. This project was designated with a Red status at the end of FY 2009 due to the need for decisions regarding the re-start of the IPM Project. An evaluation and inventory were completed to determine the usability of the current requirements and development. A contract was awarded on September 25, 2009 to complete the requirements and a functional design. The acquisition and Request for Proposal for development is scheduled for issuance in FY 2010. |

In addition, Federal Student Aid did not realize projected savings in the annual cost of the Virtual Data Center contract. This was due to the following:

- The transition to the new contractor took 11 months longer than proposed requiring Federal Student Aid to operate two data centers simultaneously, thus increasing the cost.
- Additional infrastructure was added to support new initiatives and systems that had not been included in the initial contract. These new initiatives included College.gov, Federal Student Aid's enterprise portal, the Access and Identity Management System, Enterprise Information Services, IPM System and the transition of the Direct Loan Servicing System into the Virtual Data Center.
- There was a significant increase in the computing resources used at the data center to support unanticipated increases in program volumes and services.

## Legislative and Regulatory Recommendations

Key among Federal Student Aid's mission responsibilities is the task of developing legislative recommendations. These recommendations customarily center on improving and simplifying the Title IV programs, minimizing administrative costs and improving program integrity. Our recommendations inform the Department's policymaking process, including its activities and decisions related to the reauthorization of the *HEA* and its reaction to the financing difficulties for the FFEL student lending programs. These activities are usually accomplished by direct contact with colleagues in the Department's Office of Postsecondary Education and the Office of the Under Secretary at both the senior policy level and at a staff level. These efforts, while primarily carried out by Federal Student Aid's Policy Liaison and Implementation Staff, also involve other Federal Student Aid offices and senior managers. While a portion of this policy advising is accomplished on an ongoing, informal daily basis, Federal Student Aid staff contributed to policy decision making in a more formalized way related to, among other things, legislation to address student loan financing issues and development of a simplified federal student aid process as requested by the Secretary.

## Annual Bonus Awards

As of the end of FY 2009, there were 49 Federal Student Aid senior managers. In addition, there were 12 Senior Executive Service staff. Three of the 49 senior managers and four of the 12 Senior Executive Service staff served on the Federal Student Aid Executive Leadership Team and reported directly to the Chief Operating Officer. The remaining 46 senior managers and eight Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

FY 2009 performance ratings and awards for Federal Student Aid senior managers and Senior Executive Service staff were not finalized at the time this report was prepared.

In FY 2008, the then Acting Chief Operating Officer achieved a performance rating of Outstanding. While the Acting COO received a salary for his role as the Department's Chief Financial Officer, he did not receive any additional compensation for the responsibilities he assumed as Federal Student Aid's Acting COO and he did not receive a bonus for his work at Federal Student Aid.

At the end of FY 2008, there were 49 Federal Student Aid senior managers. In addition, there were 12 Senior Executive Service staff. Three of the 49 senior managers and three of the 12 Senior Executive Service staff served on the Federal Student Aid Executive Leadership Team and reported directly to the Chief Operating Officer. The remaining 46 senior managers and nine Senior Executive Service staff served in a variety of senior positions and capacities within Federal Student Aid.

For FY 2008, ratings and awards for 46 of the 49 senior managers who did not serve on the Executive Leadership Team last year were as follows:  22 achieved a performance rating of Outstanding, 14 achieved a performance rating of Highly Successful and 10 achieved a performance rating of Fully Successful. All senior managers were eligible for a rating.

Award amounts for those achieving an Outstanding rating ranged from a low of $3,907 to a high of $10,000, with a median award of $8,550. Award amounts for those achieving a Highly Successful rating ranged from a low of $2,688 to a high of $9,008, with a median award of $4,500. Those receiving a rating of Fully Successful were not eligible for an award.

FY 2008 approved ratings and awards for the six members of the Executive Leadership Team and the remaining nine Senior Executive Service staff were as follows: five achieved a performance rating of Outstanding, nine achieved a performance rating of Highly Successful and one received a performance rating of Fully Successful.

Award amounts for those achieving an Outstanding rating ranged from a low of $15,351 to a high of $34,300, with a median award of $25,982. Award amounts for those achieving a Highly Successful rating ranged from a low of $7,495 to a high of $19,322, with a median award of $7,943. Those receiving a rating of Fully Successful were not eligible for an award.

For additional information, please refer to:
http://www.ed.gov/policy/highered/leg/hea98/sec101D.html.

## Report of the Federal Student Aid Ombudsman

FY 2009 marked the tenth anniversary of the Office of the Ombudsman in Federal Student Aid (Ombudsman Office). Established by the 1998 Amendments to the *HEA,* the Office began operations on September 30, 1999.

Consistent with its statutory mission, the Ombudsman Office uses informal dispute resolution processes to address complaints about Title IV financial aid programs. The office applies a collaborative approach in working with institutions of higher education, lenders, guaranty agencies, loan servicers and other participants in student aid programs. Individual complaint data is compiled into the Ombudsman Case Tracking System (OCTS). Information is summarized for internal and external reports for Federal Student Aid and the industry in general and to identify systemic issues affecting Title IV programs. Implementation of systemic solutions can at times prevent problems, an approach preferable to resolving individual problems as they occur.

Since its inception, the Ombudsman Office has handled more than 162,200 complaints, including 23,765 in FY 2009, a 25 percent increase over FY 2008. The greatest increase was in the "General Assistance" classification. General assistance cases, approximately 78 percent of all cases received, are addressed within one to three days. Research cases represented about 22 percent of all cases received in FY 2009.

Cases classified as "Research" are more complex, historically they require more intensive resolution activity to close and may carry over as open cases from one fiscal year to the next.

FY 2009 began with 1,610 open research cases; it ended with 1,339 open. At the same time, the number of new research cases increased by 6.5 percent.

Loan Cancellation/Discharge issues represented the top research problem area for FY 2009 and case analysis shows that more customers escalate Loan Cancellation/Discharge issues to Executive or Legislative offices than any other type of Ombudsman issue. The most common problem within the Loan Cancellation/Discharge category relates to Total and Permanent Disability (TPD). TPD has been the predominant individual research case issue for several years, with consistent complaints of undue process complexity, lack of transparency, inadequacy of communication and applicant burden. Continuing an emphasis on TPD cases begun in FY 2007, which identified systemic problems and needed process improvements, Ombudsman representatives participated in a task force convened in FY 2008 to evaluate and improve disability discharge procedures. Despite implementation of some task force improvements in 2009 and changes resulting from the *HEOA*, the problem with TPD applications persists, making those the most time-consuming and problematic cases to resolve. Risk associated with elements of the TPD process was confirmed when one court case in 2009 found that correspondence denying TPD for "medical review failure" does not meet constitutional due process requirements. The Ombudsman Office will continue to work with program and policy officials to identify potential improvements that can prevent problems with the TPD process.

Significant increases in Federal Student Aid Ombudsman cases in three other issue areas suggest that adverse economic conditions continue to affect student loan borrowers. When compared to FY 2008, FY 2009 numbers reveal increases in cases relating to default, repayment plans/amounts and general Federal Student Aid assistance questions.

After July 1, 2009, inquiries about the newly implemented Income Based Repayment Plan, its relationship to the Public Service Loan Forgiveness Plan and a new *HEOA*-enacted in-state tuition provision for military personnel and their dependents generated additional calls. The Office will continue to work with program and policy officials, as well as loan holders, to use questions about Income Based Repayment and Public Service Loan Forgiveness as effective feedback mechanisms for improved program information and impact analysis.

Throughout FY 2009, the Ombudsman responded to numerous inquiries received from Executive (i.e., White House, Secretary, Chief Operating Officer, etc.) and Legislative offices. Problems with TPD discharge represented the most frequent issue in those inquiries.

The Office emphasized its ongoing work with the Student Loan Ombudsman Caucus (Caucus) in part through the May 2009 Ombudsman Training Conference in Washington, D.C. Caucus members from across the country joined ombudsman specialists from Kansas, Iowa, Chicago and Washington, D.C. for “A Capital Event” to focus on lessons learned through ten years of effective case experiences and to plan for the next decade.

Established in 2007, the Caucus brings interested parties together to discuss emerging federal student aid industry trends, provide training and develop aggregated information on systemic issues. In addition to meeting with Caucus member agencies and others to identify and address issues common to the industry, the Office prepares tailored reports for individual agency use. There were three primary emphases in working with the Caucus in 2009. One was to increase the number of Caucus members contributing data about case issues that do not come to the Department of Education so that ombudsmen can more accurately identify areas where problems can be prevented. A second emphasis was on interactive training to promote consistency in ombudsman practices; Federal Student Aid participated in monthly conference calls, training programs in Indiana, Florida and hosted the May 2009 conference in Washington, DC, as part of the “best practices” interest. Another focus was on referring more complainants to the ombudsman designee at the agencies for their direct intervention. While the customer can return to the Federal Student Aid Ombudsman if the problem persists, having the ombudsman designee at the responsible agency focus on the problem and its root causes can be an effective intervention strategy. With the agency ombudsman reporting the case types as part of the Caucus initiative, industry-wide preventive measures can be formulated.

Information about the Ombudsman Office is disseminated to the industry and borrowers throughout the student aid life cycle. The Office’s Web site (http://www.ombudsman.ed.gov) helps individuals resolve loan problems independently, learn about student aid information and resources and submit issues or complaints electronically. The Office of the Ombudsman brochure is available in print or electronically and is used by colleges and universities to inform students that the Office is a final resource after other service avenues are unsuccessful. The monthly Ombudsman Newsletter focuses on Ombudsman case activity and industry news. Although these efforts help inform many populations of the Office's role, reports about new legislation, technology changes and case details identify areas where improvements can be made. In FY 2009, the OCTS was transitioned to an improved, supportable-technology platform; the web site was updated with new program details; the integrated voice response unit messaging was revised; and internal case management processes were enhanced to ensure consistency in use of Ombudsman principles of impartiality, independence, confidentiality and informality.

Customer satisfaction with the Ombudsman Office is measured, in part, through independently conducted telephone surveys. Closed cases are chosen at random and customers are asked to rate service accessibility, Ombudsman representatives' knowledge, timeliness of case resolution, level of satisfaction with the resolution and overall service. On a scale of 1 – 5, with 5 the highest rating, survey results are calculated weekly and cumulatively for the fiscal year. Only ratings of 4.0 or higher meet the Ombudsman customer satisfaction performance goal. The average FY 2009 customer satisfaction rating was 4.57. Customers also write or call independently to express appreciation for assistance from the Office.

As the Federal Student Aid Ombudsman Office ends one decade and begins another, key efforts will be to maintain individual case efficiencies while improving root cause analysis, systemic issue identification and preventive outreach.

# Financial Section

## Message from the Chief Financial Officer

In FY 2009, Federal Student Aid faced many new challenges. With these new challenges came enormous financial risks. Thanks to the dedication of very talented staff throughout the Department of Education, we were able to successfully meet these new challenges while effectively managing the risk that they imposed upon us. Below is a list of some of the challenges we faced in FY 2009:

John W. Hurt, III
Chief Financial Officer

- Continued implementation of the *ECASLA*, an aggressive plan that injected $57 billion of capital into the student loan market between August 2008 and September 2009 to ensure all eligible students and families received Federal loan aid.

- Expanded Federal Student Aid loan origination and servicing capacity to handle a 54 percent increase in federally-held loans, from $157 billion on September 30, 2008 to $241 billion on September 30, 2009.

- Implementation of the *Recovery Act*, which provided an additional $17 billion for Pell Grants in FY 2009 and FY 2010 and $200 million for FWS in academic year 2009.

Meanwhile, we continued to deliver aid through our normal operations, with limited additional administrative funding and a declining staff base. In total, we delivered $113 billion in grant, work-study and loan assistance to over 13 million postsecondary students and their families in FY 2009. We accomplished all of this while experiencing a five percent reduction in staffing.

Federal Student Aid's new initiatives significantly impacted not only policy decisions, program systems and performance reporting, but also financial management and internal control. In the context of our internal control framework, new processes and controls were documented and assessed for each of these new initiatives. In addition, Federal Student Aid continued to address previously reported problems. As a result of this focus on internal control, Federal Student Aid was able to achieve the following:

- An unqualified opinion was received on the principal financial statements for the eighth consecutive year, demonstrating a clear pattern of financial accountability.
- No material weaknesses were identified as part of our Report on Internal Control for the seventh consecutive year.

- Reasonable assurance was provided of our internal control over financial reporting. The successful results of this assessment effort are described further in the "Analysis of Federal Student Aid's Systems, Controls and Legal Compliance" section.
- Continuous successful implementation of the *ECASLA* initiatives, with no significant problems.
- Successful implementation of additional servicers to handle the enormous increase in loan servicing volume from *ECASLA*, with no significant problems.

Also, through cooperative efforts among the Department's Office of the Chief Financial Officer, Budget Service and Federal Student Aid, the Department continued to correct two significant deficiencies in credit reform estimation and information systems controls that were identified in the FY 2008 Internal Control Report. The complexity of these two issues has required an ongoing multi-year effort. As a result of these concerted efforts, in the FY 2009 Internal Control Report the auditors recognized improvements in both areas as well as acknowledged the challenges presented by the implementation, accounting and maintenance of the ECASLA activities.

FY 2009 has brought many financial management and internal control challenges. I am proud to be working with a group of professionals throughout the Department who so successfully met these challenges.

Sincerely,

John W. Hurt, III
Chief Financial Officer
November 16, 2009

## Principal Financial Statements and Notes to Principal Financial Statements

# United States Department of Education
# Federal Student Aid
# Consolidated Balance Sheet
## As of September 30, 2009 and 2008

(Dollars in Millions)

| | FY 2009 | FY 2008 |
|---|---|---|
| **Assets:** | | |
| Intragovernmental: | | |
| Fund Balance with Treasury (Note 3) | $ 66,807 | $ 56,915 |
| Accounts Receivable (Note 4) | (3) | |
| Total Intragovernmental | 66,804 | 56,915 |
| Cash and Other Monetary Assets (Note 5) | 2,414 | 1,663 |
| Accounts Receivable, Net (Note 4) | 504 | 83 |
| Credit Program Receivables, Net (Note 6) | 233,959 | 134,546 |
| General Property, Plant and Equipment, Net (Note 7) | 34 | 43 |
| Other Assets (Note 8) | 272 | 37 |
| **Total Assets (Note 2)** | **$ 303,987** | **$ 193,287** |
| **Liabilities:** | | |
| Intragovernmental: | | |
| Accounts Payable | $ | $ 2 |
| Debt (Note 9) | 234,858 | 128,256 |
| Guaranty Agency Federal and Restricted Funds Due to Treasury (Note 5) | 2,414 | 1,663 |
| Payable to Treasury (Note 6) | 3,569 | 3,766 |
| Other Intragovernmental Liabilities (Note 10) | 11,395 | 7,022 |
| Total Intragovernmental | 252,236 | 140,709 |
| Accounts Payable | 1,734 | 1,128 |
| Accrued Grant Liability (Note 11) | 1,929 | 862 |
| Liabilities for Loan Guarantees (Note 6) | 20,543 | 43,322 |
| Other Liabilities (Note 10) | 494 | 67 |
| **Total Liabilities** | **$ 276,936** | **$ 186,088** |
| Commitments and Contingencies (Note 18) | | |
| **Net Position:** | | |
| Unexpended Appropriations | $ 27,328 | $ 13,472 |
| Cumulative Results of Operations | (277) | (6,273) |
| **Total Net Position (Note 12)** | **$ 27,051** | **$ 7,199** |
| **Total Liabilities and Net Position** | **$ 303,987** | **$ 193,287** |

***The accompanying notes are an integral part of these statements.***

## United States Department of Education
## Federal Student Aid
## Consolidated Statement of Net Cost
### For the Years Ended September 30, 2009 and 2008
(Dollars in Millions)

| | FY 2009 | FY 2008 |
|---|---|---|
| **Program Costs** | | |
| **Ensure Accessibility, Affordability, and Accountability of Higher Education and Career and Technical Advancement** | | |
| Gross Costs | $ (11,062) | $ 28,788 |
| Less: Earned Revenue | 11,079 | 9,029 |
| Net Program Costs | (22,141) | 19,759 |
| **Total Program Costs** | **$ (22,141)** | **$ 19,759** |
| **American Recovery and Reinvestment Act** | | |
| Gross Costs | $ 7,572 | $ **0** |
| Less: Earned Revenue | | |
| Net Program Costs | **7,572** | |
| **Total Program Costs** | **$ 7,572** | **$ 0** |
| **Net Cost of Operations (Notes 13 &16)** | **$ (14,569)** | **$ 19,759** |

***The accompanying notes are an integral part of these statements.***

# United States Department of Education
## Federal Student Aid
## Consolidated Statement of Changes in Net Position
### For the Years Ended September 30, 2009 and 2008

(Dollars in Millions)

| | FY 2009 | | | | FY 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | | Cumulative Results of Operations | | Unexpended Appropriations | | Cumulative Results of Operations | | Unexpended Appropriations |
| **Beginning Balance** | $ | (6,273) | $ | 13,472 | $ | (2,574) | $ | 14,420 |
| **Budgetary Financing Sources:** | | | | | | | | |
| Appropriations Received | $ | | $ | 41,951 | $ | | $ | 28,549 |
| Other Adjustments (rescissions, etc) | | 1 | | (26) | | (3) | | (1,300) |
| Appropriations Used | | 28,069 | | (28,069) | | 28,197 | | (28,197) |
| Nonexpenditure Financing Sources-Transfers-Out | | | | | | (190) | | |
| **Other Financing Sources:** | | | | | | | | |
| Imputed Financing from Costs Absorbed by Others | | 9 | | | | 8 | | |
| Others | | (36,652) | | | | (11,952) | | |
| **Total Financing Source** | **$** | **(8,573)** | **$** | **13,856** | **$** | **16,060** | **$** | **(948)** |
| **Net Cost of Operations** | **$** | **14,569** | **$** | | **$** | **(19,759)** | **$** | |
| **Net Change** | **$** | **5,996** | **$** | **13,856** | **$** | **(3,699)** | **$** | **(948)** |
| **Ending Balances (Note 12)** | **$** | **(277)** | **$** | **27,328** | **$** | **(6,273)** | **$** | **13,472** |

***The accompanying notes are an integral part of these statements.***

**United States Department of Education**
**Federal Student Aid**
**Combined Statement of Budgetary Resources**
**For the Years Ended September 30, 2009 and 2008**

(Dollars in Millions)

| | FY 2009 Budgetary | FY 2009 Non-Budgetary Credit Reform Financing Accounts | FY 2008 Budgetary | FY 2008 Non-Budgetary Credit Reform Financing Accounts |
|---|---|---|---|---|
| **Budgetary Resources:** | | | | |
| Unobligated balance, brought forward, October 1 | $ 3,620 | $ 26,517 | $ 4,449 | $ 36,792 |
| Recoveries of prior year Unpaid Obligations | 398 | 8,035 | 1,447 | 3,115 |
| Budgetary Authority: | | | | |
| Appropriations | 41,960 | 130 | 28,562 | 151 |
| Borrowing Authority (Note 15) | | 200,214 | | 57,743 |
| Spending authority from offsetting collections (gross): | | | | |
| Earned | | | | |
| Collected | 1,569 | 45,512 | 1,638 | 33,510 |
| Change in Receivables from Federal Sources | | (3) | | |
| Subtotal | $ 43,529 | $ 245,853 | $ 30,200 | $ 91,404 |
| Temporarily not available pursuant to Public Law | (887) | | | |
| Permanently not available | (688) | (13,130) | (2,058) | (16,835) |
| **Total Budgetary Resources (Note 15)** | **$ 45,972** | **$ 267,275** | **$ 34,038** | **$ 114,476** |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: Direct (Note 15) | $ 32,496 | $ 257,585 | $ 30,418 | $ 87,959 |
| Unobligated Balances: Apportioned | 10,376 | 474 | 1,166 | 396 |
| Unobligated Balance not available | 3,100 | 9,216 | 2,454 | 26,121 |
| **Total Status of Budgetary Resources** | **$ 45,972** | **$ 267,275** | **$ 34,038** | **$ 114,476** |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net: Unpaid obligations, brought forward, October 1 | $ 12,927 | $ 41,157 | $ 12,485 | $ 14,425 |
| Obligation Incurred, net (+/-) | 32,496 | 257,585 | 30,418 | 87,959 |
| Gross Outlays | (27,295) | (157,132) | (28,529) | (58,112) |
| Recoveries of prior year unpaid obligations, actual | (398) | (8,035) | (1,447) | (3,115) |
| Change in uncollected customer payments from Federal Sources (+/-) | | 3 | | |
| | **$ 17,730** | **$ 133,578** | **$ 12,927** | **$ 41,157** |
| Obligated Balance, net, end of period: | | | | |
| Unpaid Obligations | $ 17,730 | $ 133,575 | $ 12,927 | $ 41,157 |
| Uncollected customer payments from Federal Sources | | 3 | | |
| **Total, unpaid obligated balance, net, end of period** | **$ 17,730** | **$ 133,578** | **$ 12,927** | **$ 41,157** |
| **Net Outlays:** | | | | |
| Gross Outlays | $ 27,295 | $ 157,132 | $ 28,529 | $ 58,112 |
| Offsetting collections | (1,569) | (45,512) | (1,638) | (33,510) |
| Distributed Offsetting receipts | (31,646) | | (28) | (5,750) |
| **Net Outlays (Note 15)** | **$ (5,920)** | **$ 111,620** | **$ 26,863** | **$ 18,852** |

***The accompanying notes are an integral part of these statements.***

# Notes to Principal Financial Statements
## For the Years Ended September 30, 2009 and September 30, 2008

## Note 1. Summary of Significant Accounting Policies

### Reporting Entity

Federal Student Aid was created as a PBO within the Department under the *HEA* from previously existing Department student financial assistance programs. Federal Student Aid operates under the PBO mandate to develop a management structure driven by strong incentives to manage for results. Federal Student Aid's primary goal is to assist lower-income and middle-income students in overcoming the financial barriers that make it difficult to attend and complete postsecondary education. Federal Student Aid is responsible for administering direct loans, guaranteed loans and grant programs.

The Direct Loan Program, added to the *HEA* by the *Student Loan Reform Act of 1993*, enables Federal Student Aid to make loans directly to eligible undergraduate and graduate students and their parents through participating schools. Federal Student Aid borrows money from the Treasury to fund the loans. The program provides interest subsidies for eligible borrowers.

The FFEL Program, initially authorized by the *HEA*, operates through state and private nonprofit guaranty agency agencies to provide loan guarantees and interest subsidies on loans made by lenders to eligible students.

Under the Direct Loan and FFEL Programs, loans are made to individuals who meet statutorily set eligibility criteria and attend eligible institutions of higher education—public or private two- and four-year institutions, graduate schools and vocational training schools. Students and their parents, based on eligibility criteria, receive loans regardless of income or credit rating. Student borrowers who demonstrate financial need also receive federal interest subsidies.

The *ECASLA* amended the FFEL Program to authorize the Secretary to purchase or enter into forward commitments to purchase FFEL loans. This temporary loan purchase authority was to expire on September 30, 2009; however, P.L. 110-350 extended the authority through September 30, 2010. The Department has implemented three activities under this temporary loan purchase authority. These activities are: (1) loan purchase commitments under which the Department purchases loans directly from FFEL lenders; (2) loan participation purchases in which the Department purchases participation interests in FFEL loans; and (3) an ABCP Conduit in which the Department enters into a forward commitment to purchase FFEL loans from a conduit, as needed, to allow the conduit to repay short-term liquidity loans used to re-finance maturing commercial paper.

The TEACH Program was implemented beginning July 1, 2008. This program, added to the *HEA* by the *CCRAA*, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students.

Grant appropriations funding the Pell Grant Program and campus-based student aid programs enable Federal Student Aid to provide educational grants and other financial assistance to eligible applicants. Grants are not repaid to the federal government. The Pell Grant Program provides grant aid to low-income and middle-income undergraduate students. Awards vary in proportion to the financial circumstances of students and their families. The campus-based student aid programs provide educational grants and other financial assistance to eligible applicants. These programs include the Supplemental Educational Opportunity Grant, FWS and Federal Perkins Loan Programs. Campus-based programs are not material to these statements and have been included with other programs reported under grant programs.

The *Recovery Act*, enacted on February 17, 2009 as P.L. 111-5, provides funding for improving schools, raising students' achievement, driving reform and producing better results for children and young people for the long term health of the nation. The *Recovery Act* funds provided to the Department include additional funding for student aid administration and student financial assistance grant programs managed and administered by Federal Student Aid. These activities are accounted for separately from non-*Recovery Act* funds. (See Note 17)

**Basis of Accounting and Presentation**

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position and budgetary resources of the Federal Student Aid reporting group, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*. The financial statements were prepared from the books and records of Federal Student Aid, in accordance with accounting principles generally accepted in the United States of America for federal entities, issued by the Federal Accounting Standards Advisory Board, and OMB Circular No. A-136 *Financial Reporting Requirements*, as revised June 2009. These financial statements are different from the financial reports prepared by the Department pursuant to OMB directives that are used to monitor and control Federal Student Aid's use of budgetary resources.

Federal Student Aid's financial statements represent the reporting organization, Federal Student Aid, within the Department of Education, which is itself a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation providing resources and legal authority to do so.

The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

Transactions and balances among Federal Student Aid funds have been eliminated from the consolidated financial statements.

### Use of Estimates

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make assumptions and estimates that directly affect the amounts reported in the financial statements. Actual results may differ from those estimates.

The *Federal Credit Reform Act of 1990* (*Credit Reform Act*) underlies the proprietary and budgetary accounting treatment of direct and guaranteed loans. The long-term cost to the government for direct loans or loan guarantees, other than for general administration of the programs, is referred to as "subsidy cost." Under the *Credit Reform Act*, subsidy costs for loans obligated beginning in FY 1992 are estimated at the net present value of projected lifetime costs in the year the loan is obligated. Subsidy costs are re-estimated annually.

Estimates for credit program receivables and liabilities contain assumptions that have a significant impact on the financial statements. The primary components of this assumption set include, but are not limited to, collections (including loan consolidations), repayments, default rates, prevailing interest rates and loan volume. Actual loan volume, interest rates, cash flows and other critical components used in the estimation process may differ significantly from the assumptions made at the time the financial statements were prepared. Minor adjustments to any of these components may create significant changes to the estimate.

Federal Student Aid and the Department estimate all future cash flows associated with the Direct Loan, FFEL and TEACH Programs. Projected cash flows are used to develop subsidy estimates. Subsidy cost can be positive or negative; negative subsidies occur when expected program inflows of cash (e.g., repayments and fees) exceed expected outflows. Subsidy cost is recorded as the initial amount of the loan guarantee liability when guarantees are made or as a valuation allowance to government-owned loans and interest receivable (i.e., direct and defaulted guaranteed loans).

Federal Student Aid and the Department use a computerized cash flow projection Student Loan Model to calculate subsidy estimates for the Direct Loan, FFEL and TEACH Programs. Each year, the Department re-evaluates the estimation methods related to changing conditions. Federal Student Aid and the Department use a probabilistic technique to forecast interest rates based on different methods to establish the relationship between an event's occurrence and the magnitude of its probability. The Department's approach estimates interest rates under numerous scenarios and then bases interest rates on the average interest rates weighted by the assumed probability of each scenario occurring. Probabilistic methodology facilitates the modeling of the Department's unique loan programs.

For each program, cash flows are projected over the life of the loans, aggregated by loan type, cohort year and risk category. The loan's cohort year represents the year a direct loan was obligated or a loan was guaranteed, regardless of the timing of disbursements. Risk categories include two-year colleges, freshmen and sophomores at four-year colleges, juniors and seniors at four-year colleges, graduate schools and proprietary (for-profit) schools.

Estimates reflected in these statements were prepared using assumptions developed for the FY 2010 Mid-Session Review, a government-wide exercise required annually by OMB. These estimates are based on the most current information available to Federal Student Aid and the Department at the time the financial statements were prepared. Assumptions and their impact are updated after the Mid-Session Review to account for significant subsequent changes in activity. Management has a process to review these estimates in the context of subsequent changes in activity and assumptions, and to reflect the impact of changes, as appropriate.

Federal Student Aid and the Department recognize that cash flow projections and the sensitivity of changes in assumptions can have a significant impact on estimates. Management has attempted to mitigate fluctuations in the estimates by using trend analysis to project future cash flows. Changes in assumptions could significantly affect the amounts reflected in these financial statements. For example, a minimal change in the projected long-term interest rate charged to borrowers could change the current subsidy re-estimate by a significant amount. (See Note 6)

### Budget Authority

Budget authority is the authorization provided by law for the Department and Federal Student Aid to incur financial obligations that will result in outlays. Federal Student Aid's budgetary resources include (1) unobligated balances of resources from prior years, (2) recoveries of prior-year obligations and (3) new resources, which include appropriations, authority to borrow from Treasury and spending authority from collections.

Unobligated balances associated with resources expiring at the end of the fiscal year remain available for five years after expiration only for upward adjustments of prior year obligations, after which they are canceled and may not be used. Unobligated balances of resources that have not expired at year-end are available for new obligations placed against them, as well as upward adjustments of prior year obligations.

Authority to borrow from Treasury provides most of the funding for disbursements made under the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. Subsidy and administrative costs of the programs are funded by appropriations. Budgetary resources from collections are used primarily to repay Federal Student Aid's debt to Treasury. Major sources of collections include (1) principal and interest collections from borrowers, (2) related fees and (3) interest from Treasury on balances in certain credit financing accounts that make and administer loans and guarantees.

Borrowing authority is an indefinite budgetary resource authorized under the *Credit Reform Act*. This resource, when realized, finances the unsubsidized portion of the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. In addition, borrowing authority is requested in advance of expected collections to cover negative subsidy. Treasury prescribes the terms and conditions of borrowing authority and lends to the financing account amounts as appropriate. Amounts borrowed, but not yet disbursed, are included in uninvested funds and earn interest. Treasury uses the same weighted average interest rates for both the interest charged on borrowed funds and the interest earned on uninvested funds. The Department may carry forward borrowing authority to future fiscal years provided that cohorts are disbursing loans. All borrowings from Treasury are effective on October 1 of the current fiscal year, regardless of when the Department borrowed the funds, except for amounts borrowed to make annual interest payments.

**Assets**

Assets are classified as either entity or non-entity assets. Entity assets are those that the Department has authority to use for its operations. Non-entity assets are those held by the Department but not available for use in its operations. The Department combines its entity and non-entity assets on the balance sheet and discloses its non-entity assets in the notes. (See Note 2)

**Fund Balance with Treasury**

The Fund Balance with Treasury includes general, revolving, special and other funds available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. Treasury processes cash receipts and cash disbursements for Federal Student Aid. Federal Student Aid's records are reconciled with those of Treasury.

A portion of the general fund is funded in advance by multi-year appropriations for obligations anticipated during the current and future fiscal years. Revolving funds conduct continuing cycles of business-like activity and do not require annual appropriations. Their fund balance is derived from borrowings, as well as collections from the public and other federal agencies. Other funds, which are non-budgetary, primarily consist of deposit and receipt funds.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include receivables for undelivered orders and unpaid expended authority.

The Fund Balance with Treasury also includes funds received for grants during FY 2009, which are statutorily not available for obligation until FY 2010. Since this is a deferral made in law, it reduces total budgetary resources during FY 2009. (See Notes 3 and 12)

**Accounts Receivable**

Accounts Receivable are amounts due to Federal Student Aid from the public and other federal agencies. Receivables from the public result from overpayments to recipients of grants and other financial assistance programs, and disputed costs resulting from audits of educational assistance programs. Amounts due from other federal agencies result from reimbursable agreements entered into by Federal Student Aid with these agencies to provide various goods and services. Accounts receivable are reduced to net realizable value by an allowance for uncollectible amounts. Estimates for the allowance for loss on uncollectible accounts are based on historical data. (See Note 4)

### Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of guaranty agency reserves that represent the federal government's interest in the net assets of state and nonprofit FFEL Program guaranty agencies. Guaranty agency reserves are classified as non-entity assets with the public (See Notes 2 and 5) and are offset by a corresponding liability due to Treasury. Guaranty agency reserves include initial federal start-up funds, receipts of federal reinsurance payments, insurance premiums, guaranty agency share of collections on defaulted loans, investment income, administrative cost allowances and other assets.

Section 422A of the *HEA* required FFEL guaranty agencies to establish a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund by December 6, 1998. The Federal Fund and the non-liquid assets developed or purchased by a guaranty agency, in whole or in part with federal funds, are the property of the United States and reflected in the *Budget of the United States Government*. However, such ownership by the federal government is independent of the actual control of the assets. Payments to the Department from guaranty agency Federal Funds, which increase Fund Balance with Treasury, are remitted to Treasury.

Federal Student Aid and the Department disburse funds to a guaranty agency. A guaranty agency, through its Federal Fund, pays lender claims and default aversion fees. The Operating Fund is the property of the guaranty agency except for amounts an agency borrows from the Federal Fund (as authorized under Section 422A of the *HEA*). The Operating Fund is used by the guaranty agency to fulfill responsibilities that include repaying money borrowed from the Federal Fund, and performing default aversion and collection activities.

### Credit Program Receivables and Liabilities for Loan Guarantees

The financial statements reflect the Department's estimate of the long-term cost of direct and guaranteed loans in accordance with the *Credit Reform Act*. Loans and interest receivable are valued at their gross amounts less an allowance for the present value of amounts not expected to be recovered and thus having to be subsidized—called "allowance for subsidy". The difference is the present value of the cash flows to and from Federal Student Aid that are expected from the receivables over their projected lives. Similarly, liabilities for loan guarantees are valued at the present value of the cash outflows from Federal Student Aid less the present value of related inflows. The estimated present value of net long-term cash outflows of Federal Student Aid for subsidized costs is net of recoveries, interest supplements and offsetting fees. Federal Student Aid records all credit program loans and loan guarantees at their present values.

Credit program receivables for activities under the temporary loan purchase authority include the present value of future cash flows related to the participation agreements or purchased loans. Subsidy is transferred, which may be prior to purchasing loans, and is recognized as subsidy expense in the Statement of Net Cost. The cash flows of these authorities also include inflows and outflows associated with the underlying or purchased loans and other related activities including any positive or negative subsidy transfers.

Components of subsidy costs for loans and guarantees include defaults (net of recoveries), contractual payments to third-party private loan collectors who receive a set percentage of amounts collected and, as an offset, origination and other fees collected. For direct loans, the difference between interest rates incurred by the Department and Federal Student Aid on its borrowings from Treasury and interest rates charged to target groups is also subsidized (or may provide an offset to subsidy if the Department's rate is less). The corresponding interest subsidy in loan guarantee programs is the payment of interest supplements to third-party lenders in order to pay down the interest rates on loans made by those lenders. Subsidy costs are recognized when direct loans or guaranteed loans are disbursed to borrowers and re-estimated each year. (See Note 6)

### General Property, Plant and Equipment

In accordance with the Department's policy, Federal Student Aid capitalizes single items of property and equipment with a cost of $50,000 or more that have an estimated useful life greater than two years. Additionally, Federal Student Aid capitalizes bulk purchases of property and equipment with an aggregate cost of $500,000 or more. A bulk purchase is defined as the purchase of like items related to a specific project or the purchase of like items occurring within the same fiscal year that have an estimated useful life greater than two years. Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. Internal Use Software meeting the above cost and useful life criteria is also capitalized. Internal Use Software is either purchased off the shelf, internally developed or contractor developed solely to meet the agency's needs. (See Note 7)

The Department adopted the following useful lives for its major classes of depreciable property and equipment:

**Depreciable Property and Equipment**

(In Years)

| Major Class | Useful Life |
|---|---|
| Information Technology, Internal Use Software and Telecommunications Equipment | 3 |
| Furniture and Fixtures | 5 |

### Other Assets

Other assets include assets not reported separately on the balance sheet. Federal Student Aid's other assets (with the public) consist of payments made to grant recipients in advance of their expenditures and in-process disbursements for the FFEL Program. (See Note 8)

### Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. However, no liabilities can be paid by Federal Student Aid or the Department without budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty that an appropriation will be enacted. The government, acting in its sovereign capacity, can abrogate liabilities that arise from activities other than contracts. FFEL Program and Direct Loan

Program liabilities are entitlements covered by permanent indefinite budget authority. (See Note 10)

### Debt

The Department borrows to provide funding for the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. The liability to Treasury from borrowings represents unpaid principal at year-end. Federal Student Aid repays the principal based on available fund balances. Interest on the debt is calculated at fiscal year-end using rates set by Treasury, with such rates generally fixed based on the rate for 10-year Treasury securities. As discussed in Note 6, the interest received by Federal Student Aid from borrowers will vary from the rate paid to Treasury. Principal and interest payments to Treasury are made annually. (See Note 9)

### Accrued Grant Liability

Disbursements of grant funds are recognized as expenses at the time of disbursement. However, some grant recipients incur expenditures prior to initiating a request for disbursement based on the nature of the expenditures. A liability is accrued by Federal Student Aid for expenditures incurred by grantees prior to their receiving grant funds to cover the expenditures. The amount is estimated using statistical sampling. (See Note 11)

### Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations include undelivered orders and unobligated balances, except for federal credit financing and liquidating funds. Cumulative results of operations represent the net difference since inception between (1) expenses and (2) revenues and financing sources. (See Note 12)

### Personnel Compensation and Other Employee Benefits

**Annual, Sick and Other Leave**. The liability for annual leave, compensatory time off and other vested leave is accrued when earned and reduced when taken. Each year, the accrued annual leave account balance is adjusted to reflect current pay rates. Annual leave earned but not taken, within established limits, is funded from future financing sources. (See Note 10) Sick leave and other types of non-vested leave are expensed as taken.

**Retirement Plans and Other Retirement Benefits.** Employees participate either in the Civil Service Retirement System (CSRS), a defined benefit plan or in the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, the Department contributes a fixed percentage of pay.

FERS consists of Social Security, a basic annuity plan and the Thrift Savings Plan. The Department and the employee contribute to Social Security and the basic annuity plan at rates prescribed by law. In addition, the Department is required to contribute to the Thrift Savings Plan a minimum of 1 percent per year of the basic pay of employees covered by this system and to match voluntary employee contributions up to 3 percent of the employee's basic pay, and one-half of contributions between 3 percent and 5 percent of basic pay. For FERS employees, the Department also contributes the employer's share of Medicare.

Contributions for CSRS, FERS and other retirement benefits are insufficient to fully fund the programs, and are subsidized by the Office of Personnel Management (OPM). The Department imputes its share of the OPM subsidy, using cost factors provided by OPM, and reports the full cost of the programs related to its employees.

**Federal Employees' Compensation Act.** The *Federal Employees' Compensation Act* (*FECA*) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The *FECA* Program is administered by the DOL, which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The *FECA* liability consists of two components. The first component is based on actual claims paid and recognized by the Department as a liability. Generally the Department reimburses DOL within two to three years once funds are appropriated. The second component is the estimated liability for future benefit payments based on unforeseen events such as death, disability, medical and miscellaneous costs as determined by DOL annually. (See Note 10)

### Intragovernmental Transactions

Federal Student Aid's financial activities interact with and are dependent upon the financial activities of the centralized management functions of the federal government. Due to financial regulation and management control by OMB and Treasury, operations may not be conducted and financial positions may not be reported as they would if Federal Student Aid were a separate, unrelated entity.

## Note 2. Non-Entity Assets

As of September 30, 2009 and 2008, non-entity assets consisted of the following:

**Non-Entity Assets**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Non-Entity Assets** | | |
| Intragovernmental | | |
| Fund Balance with Treasury | $ 7 | $ 8 |
| Total Intragovernmental | 7 | 8 |
| With the Public | | |
| Cash and Other Monetary Assets | 2,414 | 1,663 |
| Accounts Receivable, Net | - | 4 |
| Credit Program Receivables, Net | 184 | 186 |
| Total With the Public | 2,598 | 1,853 |
| **Total Non-Entity Assets** | **2,605** | **1,861** |
| Entity Assets | 301,382 | 191,426 |
| Total Assets | $ 303,987 | $ 193,287 |

Non-entity intragovernmental assets primarily consist of deposit fund balances. Non-entity assets with the public primarily consist of guaranty agency reserves and Federal Perkins Program Loan Receivables. (See Notes 5 and 6)

## Note 3. Fund Balance with Treasury

The Fund Balance with Treasury, by fund type, as of September 30, 2009 and 2008, consisted of the following:

**Fund Balances**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| General Funds | $ 29,662 | $ 14,874 |
| Revolving Funds | 37,124 | 42,024 |
| Special Funds | 14 | 9 |
| Other Funds | 7 | 8 |
| **Fund Balance with Treasury** | **$ 66,807** | **$ 56,915** |

The Status of Fund Balance with Treasury, as of September 30, 2009 and 2008, consisted of the following:

**Status of Fund Balance with Treasury**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Unobligated Balance | | |
| Available | $ 10,850 | $ 1,562 |
| Unavailable | 9,902 | 26,912 |
| Obligated Balance, Not Yet Disbursed | 45,161 | 28,433 |
| Authority Temporarily Precluded from Obligation | 887 | - |
| Non-Budgetary Fund Balance with Treasury | 7 | 8 |
| **Fund Balance with Treasury** | **$ 66,807** | **$ 56,915** |

## Note 4. Accounts Receivable

Accounts Receivable, as of September 30, 2009 and 2008, consisted of the following:

**Accounts Receivable**

(Dollars in Millions)

| | 2009 | | |
|---|---|---|---|
| | Gross Receivables | Allowance | Net Receivables |
| Intragovernmental | $ (3) | $ - | $ (3) |
| With the Public | 536 | (32) | 504 |
| **Accounts Receivable** | **$ 533** | **$ (32)** | **$ 501** |

| | 2008 | | |
|---|---|---|---|
| | Gross Receivables | Allowance | Net Receivables |
| Intragovernmental | $ - | $ - | $ - |
| With the Public | 118 | (35) | 83 |
| **Accounts Receivable** | **$ 118** | **$ (35)** | **$ 83** |

## Note 5. Cash and Other Monetary Assets

Cash and Other Monetary Assets consist of reserves held in the FFEL Guaranty Agency Federal Funds. Changes in the valuation of the Federal Fund increase or decrease the Department's Cash and Other Monetary Assets with a corresponding change in the Payable to Treasury. The table below presents Cash and Other Monetary Assets for the Years ended September 30, 2009 and 2008.

**Cash and Other Monetary Assets**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Beginning Balance, Cash and Other Monetary Assets** | **$ 1,663** | **$ 1,103** |
| Valuation Increase in Guaranty Agency Federal Funds | 751 | 722 |
| Less: Collections from Guaranty Agency Federal Funds | | |
| Excess Collections | - | 162 |
| Collections Remitted to Treasury | - | 162 |
| **Ending Balance, Cash and Other Monetary Assets** | **$ 2,414** | **$ 1,663** |

The $751 million net increase in the Federal Fund in FY 2009 reflects the impact of guaranty agencies' ongoing operations. During FY 2008, $162 million was remitted to the Department by a guaranty agency whose agreement with the Department requires the agency to remit funds in excess of agreed-upon working capital levels. Remitted funds were returned to Treasury.

## Note 6. Credit Programs for Higher Education

**William D. Ford Federal Direct Loan Program.** The federal government makes loans directly to students and parents through participating institutions of higher education under the Direct Loan Program. Direct Loans are originated and serviced through contracts with private vendors.

The Department disbursed approximately $37.6 billion in Direct Loans to eligible borrowers in FY 2009 and approximately $21.1 billion in FY 2008. Loans typically are disbursed in multiple installments over an academic period; as a result, loan disbursements for an origination cohort year often cross fiscal years. Half of all loan volume is obligated in the fourth quarter of a fiscal year. Regardless of the fiscal year in which they occur, disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

Approximately 7 percent of Direct Loan obligations made in an individual fiscal year are never disbursed. Loan obligations are established at a summary level based on estimates of schools' receipt of aid applications. The loan obligation may occur before a student has been accepted by a school or begins classes. For Direct Loans obligated in the 2009 cohort, an estimated $2.8 billion will never be disbursed. Eligible schools may originate direct loans through a cash advance from the Department or by advancing their own funds in anticipation of reimbursement from the Department.

The Department accrues interest receivable and records interest revenue on performing Direct Loans and, given the Department's substantial collection rates, on defaulted Direct Loans.

**Federal Family Education Loan Program.** Prior to FY 2008, the FFEL Program included only private lender loans to students and parents insured against default by the federal government. In FY 2008, the Department began administering activities under the temporary loan purchase authority by purchasing FFEL loans and participation interests in those directly from lenders. As a result, the FFEL Program also includes approximately $52 billion and $5.1 billion in direct federal assets as of September 30, 2009 and 2008, respectively.

Beginning with FFEL loans first disbursed on or after October 1, 1993, FFEL lender financial institutions became responsible for 2 percent of the cost of each default. Guaranty agencies also began paying a portion of the cost (in most cases, 5 percent) of each defaulted loan from their Federal Fund, which consists of Federal resources held in trust by the agency. FFEL lenders receive statutorily set federal interest and special allowance subsidies. Guaranty agencies receive fee payments as set by statute. In most cases, loan terms and conditions under the Direct Loan and FFEL Programs are identical.

*ECASLA* gave the Department temporary authority to purchase FFEL loans and interest in those loans. This authority was to expire on September 30, 2009; however, P.L. 110-350 extended the authority through September 30, 2010. The Department has implemented three activities under this authority: loan purchase commitments; purchases of loan participation interests; and a put, or forward purchase commitment, with an ABCP Conduit. A credit program receivable is established for loans and participation interests in loans purchased through these activities.

Under the loan purchase commitment activity, lenders have the option to sell directly to the Department fully disbursed loans originated for academic years 2007-08, 2008-09 or 2009-10. As of September 30, 2009, only loans originated for the 2009-10 academic year remain eligible for future purchase.

In loan participation transactions, lenders transfer to a custodian FFEL loans originated in academic years 2008-09 or 2009-10 on which at least one disbursement has been made. The custodian issues participation certificates to the lender that convey a participation interest in the loans. The lender sells the participation interest in the loans to the Department at the par value of these loans. The Department remits the proceeds through the custodian to the lenders. Participation interests earn a yield payable from the lender to the Department at the rate of the 91-day commercial paper rate plus 50 basis points and reset quarterly. Funds to redeem these loans from the Department's participation interest may be obtained by selling the underlying loans to the Department or by other means.

The terms of these two purchase activities permit lenders to sell loans and participation interests in loans to the Department and require them to redeem the participated loans. Lenders must commit to redeem the certificates and sell loans by September 30; the Department must finalize all related transactions by October 15. As of September 30, 2009, the Department had $26.6 billion in Notices of Intent to Sell from lenders in the purchase commitment and loan participation purchase activities.

During FY 2009, the Department, Treasury and OMB established the terms on which the Department would support an ABCP Conduit to provide liquidity to the student loan market. An ABCP Conduit under this activity issues short-term commercial paper to investors; this paper is backed by student loans pledged to the conduit. The conduit uses the proceeds of sales of its commercial paper to acquire from lenders interests in student loans. Lenders must use a portion of conduit payments to make new loans. Though the intent is for the conduit to meet demands on maturing paper by reissuing commercial paper, the Department, using its *ECASLA* authority, will purchase loans from the conduit as needed to ensure the conduit will be able to meet the demands on its paper if it is unable to refinance maturing commercial paper. The Department will purchase those pledged loans that become more than 210 days delinquent. The conduit has sold to the Department approximately $50 million of these delinquent loans as of September 30, 2009, recorded as credit program receivables. Under the terms of the Put Agreement with the conduit, the Department may also purchase pledged loans at the date that is 45 days prior to the Put Agreement expiration on January 19, 2014. As required by the *Credit Reform Act*, all cash flows to and from the Government resulting from its transactions with the ABCP Conduit are recorded in a non-budgetary credit financing account. Amounts in this account are a means of financing and are not included in the budget totals. Loans originated in academic years 2004-05 through 2007-08 are eligible to be purchased through the ABCP Conduit activity.

As of September 30, 2009, the Department has $70 billion in obligations to cover any buyer-of-last-resort activities and potential purchases of the underlying student loans under the ABCP Conduit authority. These obligations are covered by available borrowing authority. In addition, the Department has estimated approximately $4 billion in negative subsidy. The conduit, a separate legal entity, has approximately $30 billion in commercial paper outstanding.

The estimated FFEL liability for loan guarantees is reported as the present value of estimated net cash outflows. Defaulted FFEL loans are reported net of an allowance for subsidy computed using net present value methodology, including defaults, collections and loan cancellations. The same methodology is used to estimate the allowance on Direct Loan receivables.

The Department guaranteed $80.4 billion and $67.9 billion in gross non-consolidation loans to FFEL recipients during FY 2009 and FY 2008, respectively. In 2009, lenders disbursed $62.7 billion in FFEL loans from the 2008 and 2009 cohorts; in 2008, $68.8 billion were disbursed from the 2007 and 2008 cohorts. As of September 30, 2009 and 2008, total principal balances outstanding of guaranteed loans held by lenders were approximately $457 billion and $415 billion, respectively. As of September 30, 2009 and 2008, the estimated maximum government exposure on outstanding guaranteed loans held by lenders was approximately $445 billion and $405 billion, respectively. Of the insured amount, the Department would pay a smaller amount to the guaranty agencies, based on the appropriate reinsurance rates, which range from 100 to 95 percent. Any remaining insurance not paid as reinsurance would be paid to lenders by the guaranty agencies from their Federal Fund. Payments by guaranty agencies do not reduce government exposure because they are made from the Federal Fund administered by the agencies but owned by the federal government.

Approximately 15 percent of guaranteed loan commitments made in an individual fiscal year are never disbursed due to the nature of the loan commitment process. For guaranteed loans committed in the 2009 cohort, an estimated $12.5 billion will never be disbursed.

Guaranteed loans that default are initially turned over to guaranty agencies for collection, and interest receivable is accrued and recorded on the loans as the collection rate is substantial. After approximately four years, defaulted guaranteed loans not in repayment are turned over to the Department for collection. Accrued interest on the subrogated loan is calculated, but only realized upon collection.

**Federal Perkins Loan Program.** The Federal Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In some statutorily defined cases, funds are provided to reimburse schools for loan cancellations. For defaulted loans assigned to the Department, collections of principal, interest and fees, net of amounts paid by the Department to cover contract collection costs, are transferred to Treasury annually.

**TEACH Program.** Beginning July 1, 2008, the Department awards annual grants up to $4,000 to eligible undergraduate and graduate students agreeing to serve as full-time mathematics, science, foreign language, bilingual education, special education or reading teachers at high-need schools for four years within eight years of graduation. For students failing to fulfill the service requirement, grants are converted to Direct Unsubsidized Stafford Loans. Because grants could be converted to loans, for budget and accounting purposes the program is operated under the requirements of the *Credit Reform Act*.

### Loan Consolidations

Borrowers may prepay existing loans without penalty through a new consolidation loan. Under the *Credit Reform Act* and requirements provided by OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the retirement of Direct Loans being consolidated is considered a receipt of principal and interest. This receipt is offset by the disbursement related to the newly created consolidation loan. Underlying direct or guaranteed loans, performing or nonperforming, are paid off in their original cohort; new consolidation loans are originated in the cohort in which the new consolidated loan was obligated. Consolidation activity is taken into consideration in establishing subsidy rates for defaults and other cash flows. The cost of new consolidations is included in subsidy expense for the current-year cohort; the effect of prepayments on existing loans could contribute to re-estimates of prior cohort costs. The loan liability and net receivables include estimates of future prepayments of existing loans through consolidations; they do not reflect costs associated with anticipated future consolidation loans.

Direct Loan Program consolidations increased from $5.8 billion to $12.5 billion reversing the previous declining consolidation trend. FFEL to FFEL Loan consolidations continue, but at a rate that did not significantly influence FFEL re-estimated subsidy cost; performing FFEL to FFEL consolidations would not affect the Department’s actual costs. FFEL to Direct Loan consolidations are part of the $12.5 billion recorded. Direct loan consolidation activity into the FFEL Program is insignificant.

### Modification of Subsidy Cost

The recorded subsidy cost of a loan is based on a set of assumed future cash flows. Government actions that change these assumed future cash flows change subsidy cost and are recorded as loan modifications. Loan modifications are recognized under the same accounting principle as subsidy re-estimates. Modification adjustment transfers are required to adjust for the difference between current discount rates used to calculate modification costs and the discount rates used to calculate cohort interest expense and revenue. Separate amounts are calculated for modification costs and modification adjustment transfers.

**FY 2009 Modification.** *ECASLA* and its subsequent extension contained provisions authorizing the Secretary to purchase certain categories of outstanding FFEL loans. Two programs were implemented under *ECASLA* during FY 2008 and FY 2009, both for loans from academic years

2008-09 and 2009-10: 1) a standard put program in which the Department purchases loans directly from lenders, and 2) a loan participation purchase program, under which the Department purchases participation interests in loans that holders must redeem and which they may do by sale to the Department of the underlying loans. In FY 2009, the standard put program was expanded to allow the sale of loans originated for the 2007-08 academic year. In FY 2009, the Department also implemented the ABCP Conduit program under which the Department issued a five-year commitment to purchase from the conduit loans it acquires from lenders. This program allows lenders to secure private financing from the conduit at favorable rates. The Department's purchase commitment to the ABCP Conduit applies to loans acquired by the conduit and made from October 2003 through academic year 2008-09. Additionally, in response to disruptions in the commercial paper market, the Secretary used authority to approve a temporary change in the basis for calculating special allowance payments to and from loan holders for the first quarter of FY 2009.

The net effect of changes related to loan modifications executed in FY 2009 was a downward cost of $2.6 billion in the FFEL Program with a corresponding effect on the Liability for Loan Guarantees. Of this amount, $526 million related to the standard loan put authority for award year 2007-08, $778 million related to the ABCP Conduit and $1.3 billion related to the temporary change in the special allowance payment basis. The FFEL Program also recognized a net modification adjustment transfer loss of $130 million.

**FY 2008 Modification.** The *CCRAA* included a number of provisions affecting the cost of existing loans. New income-based repayment and public service loan forgiveness programs were created; income-based repayment is available to existing FFEL and Direct Loan borrowers, while public service loan forgiveness is available to existing Direct Loan borrowers. (Existing FFEL borrowers may consolidate into Direct Loans to obtain the benefit.) The Act also made retroactive changes to loan deferment provisions for certain military personnel.

The Act also eliminated the provision under which FFEL lenders designated as "exceptional performers" received a higher insurance rate on defaulted loans, reduced FFEL guaranty agencies' account maintenance fees, and lowered the percentage guaranty agencies may retain on collections of certain defaulted loans.

Loan modification savings of $2.5 billion were recorded in the FFEL Program and $4.1 billion in modification costs were recorded in the Direct Loan Program. The FFEL Program also recognized a net modification adjustment transfer saving of $30 million and the Direct Loan Program recognized a net savings of $9 million.

## Credit Program Receivables

Credit Program Receivables as of September 30, 2009 and 2008, consisted of the following:

**Credit Program Receivables**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Direct Loan Program Loan Receivables, Net | $ 152,771 | $ 109,850 |
| FFEL Program | | |
| Guaranteed Loan Program, Net (Pre-1992) | 3,480 | 3,591 |
| FFEL Program (Post-1991): | | |
| FFEL Guaranteed Loan Program, Net | 20,399 | 15,624 |
| Temporary Loan Purchase Authority: | | |
| Loan Purchase Commitment, Net | 17,032 | 64 |
| Loan Participation Purchase, Net | 39,996 | 5,230 |
| ABCP Conduit, Net | 47 | - |
| Federal Perkins Program Loan Receivables, Net | 184 | 186 |
| TEACH Program Receivables, Net | 50 | 1 |
| **Credit Program Receivables, Net** | **$ 233,959** | **$ 134,546** |

**William D. Ford Federal Direct Loan Program.** The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy.

**Direct Loan Program Loan Receivables, Net**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Principal Receivable | $ 149,437 | $ 117,610 |
| Interest Receivable | 7,370 | 5,983 |
| **Receivables** | **156,807** | **123,593** |
| Less: Allowance for Subsidy | 4,036 | 13,743 |
| **Direct Loan Program Loan Receivables, Net** | **$ 152,771** | **$ 109,850** |

Of the $156.8 billion in receivables as of September 30, 2009, $11.5 billion in loan principal was in default, compared to $10.3 billion a year earlier. Defaulted Direct Loans are held in the Department's Business Operations Default Division.

**Federal Family Education Loan Program.** The following schedule summarizes the principal and related interest receivables, net of the allowance for subsidy.

**FFEL Program Loan Receivables, Net**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **FFEL Guaranteed Loan Program (Pre-1992)** | | |
| Principal Receivable | $ 7,100 | $ 7,587 |
| Interest Receivable | 223 | 182 |
| **Receivables** | **7,323** | **7,769** |
| Less: Allowance for Subsidy | 3,843 | 4,178 |
| **FFEL Guaranteed Loan Program Receivables, Net (Pre-1992)** | **$ 3,480** | **$ 3,591** |
| **FFEL Program (Post-1991)** | | |
| Principal Receivable | | |
| FFEL Guaranteed Loan Program | 22,403 | 17,641 |
| Temporary Loan Purchase Authority: | | |
| Loan Purchase Commitment | 14,293 | 59 |
| Loan Participation Purchase | 37,020 | 5,036 |
| ABCP Conduit | 50 | - |
| Interest Receivable | | |
| FFEL Guaranteed Loan Program | 2,305 | 2,143 |
| Temporary Loan Purchase Authority: | | |
| Loan Purchase Commitment | 379 | - |
| Loan Participation Purchase | 259 | 11 |
| ABCP Conduit | 2 | - |
| **Receivables** | **$ 76,711** | **$ 24,890** |
| Less: Allowance for Subsidy | | |
| FFEL Guaranteed Loan Program | 4,309 | 4,160 |
| Temporary Loan Purchase Authority: | | |
| Loan Purchase Commitment | (2,360) | (5) |
| Loan Participation Purchase | (2,717) | (183) |
| ABCP Conduit | 5 | - |
| FFEL Guaranteed Loan Program, Net | 20,399 | 15,624 |
| Temporary Loan Purchase Authority: | | |
| Loan Purchase Commitment, Net | 17,032 | 64 |
| Loan Participation Purchase, Net | 39,996 | 5,230 |
| ABCP Conduit, Net | 47 | - |
| **FFEL Program Loan Receivables, Net** | **$ 80,954** | **$ 24,509** |

All loans and participation interests in loans purchased by the Department under the temporary loan purchase authority are federal assets; the loan receivable represents all outstanding loans and participation interests. Loan participation interests were first purchased by the Department in August 2008. Approximately $9 billion in participation interests were redeemed in FY 2009 by selling the underlying loans to the Department. No participation interests were redeemed in FY 2008.

**Federal Perkins Loan Program.** At September 30, 2009 and 2008, loans receivable, net of an allowance for loss, were $184 million and $186 million, respectively. These loans are valued at historical cost.

**TEACH Program.** At September 30, 2009 and 2008, loans receivable, net of an allowance for subsidy, were $50 million and $1 million, respectively.

### Reconciliation of Allowance for Subsidy and Liability for Loan Guarantees

**William D. Ford Federal Direct Loan Program.** The following schedule provides a reconciliation between the beginning and ending balances of the allowance for subsidy for the Direct Loan Program:

**Direct Loan Program Reconciliation of Allowance for Subsidy**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Beginning Balance, Allowance for Subsidy** | **$ 13,743** | **$ 8,245** |
| **Components of Subsidy Transfers** | | |
| Interest Rate Differential | (7,785) | (1,540) |
| Defaults, Net of Recoveries | 1,070 | 454 |
| Fees | (551) | (487) |
| Other | 2,863 | 1,498 |
| **Current Year Subsidy Transfers** | **(4,403)** | **(75)** |
| **Components of Subsidy Re-estimates** | | |
| Interest Rate Re-estimates[1] | (322) | 222 |
| Technical and Default Re-estimates | (4,878) | 946 |
| **Subsidy Re-estimates** | **(5,200)** | **1,168** |
| **Components of Loan Modifications** | | |
| Loan Modification Costs | - | 4,143 |
| Modification Adjustment Transfers | - | (9) |
| **Loan Modifications** | **-** | **4,134** |
| **Activity** | | |
| Fee Collections | 628 | 482 |
| Loan Cancellations[2] | (432) | (240) |
| Subsidy Allowance Amortization | 40 | 456 |
| Other | (340) | (427) |
| **Total Activity** | **(104)** | **271** |
| **Ending Balance, Allowance for Subsidy** | **$ 4,036** | **$ 13,743** |

[1] The interest rate re-estimate relates to subsidy associated with establishing a fixed rate for the Department's borrowing from Treasury.

[2] Loan cancellations include write-offs of loans because the primary borrower died, became disabled or declared bankruptcy.

**Federal Family Education Loan Program.** The following schedule provides a reconciliation between the beginning and ending balances of the liability for loan guarantee for the insurance portion of the FFEL Program:

### FFEL Program Reconciliation of Liabilities for Loan Guarantees

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Beginning Balance, FFEL Financing Accounts Liability for Loan Guarantees** | **$ 43,185** | **$ 50,731** |
| **Components of Subsidy Transfers** | | |
| Interest Supplement Costs | (632) | 1,212 |
| Defaults, Net of Recoveries | 494 | 43 |
| Fees | (3,495) | (449) |
| Other[1] | 2,108 | 436 |
| **Current Year Subsidy Transfers** | **(1,525)** | **1,242** |
| **Components of Subsidy Re-estimates** | | |
| Interest Rate Re-estimates | (147) | (700) |
| Technical and Default Re-estimates | (21,542) | (760) |
| **Subsidy Re-estimates** | **(21,689)** | **(1,460)** |
| **Components of Loan Modifications** | | |
| Loan Modification Costs | (2,641) | (2,464) |
| Modification Adjustment Transfers | 130 | (30) |
| **Loan Modifications** | **(2,511)** | **(2,494)** |
| **Activity** | | |
| Interest Supplement Payments | (5,389) | (8,744) |
| Claim Payments | (8,634) | (8,029) |
| Fee Collections | 4,115 | 4,107 |
| Interest on Liability Balance | 337 | 1,372 |
| Other[2] | 12,559 | 6,460 |
| **Total Activity** | **2,988** | **(4,834)** |
| **Ending Balance, FFEL Financing Account Liability for Loan Guarantees** | **20,448** | **43,185** |
| FFEL Liquidating Account Liability for Loan Guarantees | 95 | 137 |
| **Liabilities for Loan Guarantees** | **$ 20,543** | **$ 43,322** |

[1] Subsidy primarily associated with debt collections and loan cancellations due to death, disability and bankruptcy.

[2] Activity primarily associated with the transfer of subsidy for defaults; loan consolidation activity; negative special allowance payments; and loan cancellations due to death, disability and bankruptcy.

## Financing Account Interest Expense and Interest Revenue

The Department borrows from Treasury to fund the unsubsidized portion of lending activities. The Department calculates and pays Treasury interest on its borrowing at the end of each year. During the year, interest is earned on outstanding direct loans, outstanding FFEL loans purchased by the Department, participation interests and the Fund Balance with Treasury.

Subsidy amortization is calculated, in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees*, as the difference between interest revenue and interest expense. For direct loans, the allowance for subsidy is adjusted with the offset to interest revenue. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest expense.

**William D. Ford Federal Direct Loan Program.** The following schedule summarizes the Direct Loan financing account interest expense and interest revenue:

**Direct Loan Program**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Interest Expense on Treasury Borrowing | $ 7,094 | $ 6,190 |
| **Interest Expense** | **$ 7,094** | **$ 6,190** |
| Interest Revenue from the Public | $ 5,669 | $ 5,277 |
| Amortization of Subsidy | (40) | (456) |
| Interest Revenue on Uninvested Funds | 1,465 | 1,369 |
| **Interest Revenue** | **$ 7,094** | **$ 6,190** |

### Payable to Treasury

Payable to Treasury for the years ended September 30, 2009 and 2008 consisted of the following:

**Payable to Treasury**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Future Liquidating Account Collections, Beginning Balance** | **$ 3,766** | **$ 4,108** |
| Valuation of Pre-1992 Loan Liability and Allowance | 465 | 250 |
| Capital Transfers to Treasury | (662) | (592) |
| **Future Liquidating Account Collections, Ending Balance** | **3,569** | **3,766** |
| **Payable to Treasury** | **$ 3,569** | **$ 3,766** |

The liquidating account, based on available fund balance, periodically transfers Fund Balance to Treasury's account.

## Subsidy Expense

## William D. Ford Federal Direct Loan Program

### Direct Loan Program Subsidy Expense

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Components of Current Year Subsidy Transfers** | | |
| Interest Rate Differential | $ (7,785) | $ (1,540) |
| Defaults, Net of Recoveries | 1,070 | 454 |
| Fees | (551) | (487) |
| Other | 2,863 | 1,498 |
| **Current Year Subsidy Transfers** | **(4,403)** | **(75)** |
| Subsidy Re-estimates | (5,200) | 1,168 |
| Loan Modification Costs | - | 4,143 |
| **Direct Loan Subsidy Expense** | **$ (9,603)** | **$ 5,236** |

For 2009 re-estimated subsidy cost, Direct Loan subsidy cost was decreased by $5.2 billion. Changes in the assumption for income-based repayments decreased subsidy cost by $3.7 billion. Rising default rates increased subsidy cost by $374 million, interest rate changes increased costs by $350 million, and changes in deferments and forbearance rates increased costs by $313 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost by $455 million.

In the 2008 re-estimates, Direct Loan subsidy cost was increased by $1.2 billion. Changes in interest rates increased subsidy cost by $859 million, updated data on teacher loan forgiveness led to an additional increase of $481 million, and rising default rates increased subsidy cost by $194 million. These increases were partially offset by decreases due to reduced prepayments of $(606) million and changes in the rate at which loans enter repayment of $(261) million. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in projected borrower base rates would reduce projected Direct Loan subsidy cost by $465 million.

## Federal Family Education Loan Program

### FFEL Program Subsidy Expense

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| <u>FFEL Guaranteed Loan Program</u> | | |
| **Components of Current Year Subsidy Transfers** | | |
| Interest Supplement Costs | $ (632) | $ 1,212 |
| Defaults, Net of Recoveries | 494 | 43 |
| Fees | (3,495) | (449) |
| Other | 2,108 | 436 |
| **Current Year Subsidy Transfers** | **(1,525)** | **1,242** |
| Subsidy Re-estimates | (21,689) | (1,460) |
| Loan Modification Costs | (2,641) | (2,464) |
| **FFEL Guaranteed Loan Program Subsidy Expense** | **(25,855)** | **(2,682)** |
| <u>Temporary Loan Purchase Authority</u> | | |
| **Loan Purchase Commitment** | | |
| **Components of Current Year Subsidy Transfers** | | |
| Interest Supplement Costs | (3,157) | (9) |
| Defaults, Net of Recoveries | 102 | - |
| Fees | 268 | 2 |
| Other | 1,179 | 5 |
| **Current Year Subsidy Transfers** | **(1,608)** | **(2)** |
| Subsidy Re-estimates | (245) | - |
| **Loan Purchase Commitment Subsidy Expense** | **(1,853)** | **(2)** |
| **Loan Participation Purchase** | | |
| **Components of Current Year Subsidy Transfers** | | |
| Interest Supplement Costs | (2,976) | (292) |
| Defaults, Net of Recoveries | (108) | 5 |
| Fees | (811) | (476) |
| Other | 735 | 595 |
| **Current Year Subsidy Transfers** | **(3,160)** | **(168)** |
| Subsidy Re-estimates | 930 | - |
| **Loan Participation Purchase Subsidy Expense** | **(2,230)** | **(168)** |
| **ABCP Conduit** | | |
| **Components of Current Year Subsidy Transfers** | | |
| Interest Supplement Costs | (6) | - |
| Defaults, Net of Recoveries | 1 | - |
| Fees | (3) | - |
| Other | 6 | - |
| **ABCP Conduit Subsidy Expense** | **(2)** | **-** |
| **FFEL Program Subsidy Expense** | **$ (29,940)** | **$ (2,852)** |

For 2009 re-estimated subsidy cost, FFEL Guaranteed subsidy cost was decreased by $21.7 billion. Interest rate changes related to updated economic assumptions accounted for approximately $18 billion in decreased subsidy cost. A $1.5 billion increase in subsidy cost related to changes in deferment and forbearance rates was offset by other changes in assumptions such as $966 million decreased cost for changes in repayment rates; loan volume changes produced a decreased subsidy cost of $790 million. Other assumption updates produced offsetting costs with the remainder attributable to interest on the re-estimate. The subsidy rate is sensitive to interest rate fluctuations, for example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $16.4 billion.

In the 2008 re-estimates, FFEL subsidy cost was decreased by $1.5 billion. Changes in interest rate forecasts decreased subsidy cost by $8.7 billion. This decrease was partially offset by increases of $4.4 billion due to reduced prepayments, $2.5 billion due to changes in projected guaranty agency retention of collections on defaulted loans, and $1.3 billion due to greater use of teacher loan forgiveness benefits. The subsidy rate is sensitive to interest rate fluctuations. For example, a 1 percent increase in borrower interest rates and the guaranteed yield for lenders would increase projected FFEL costs by $16.3 billion.

### Subsidy Rates

The subsidy rates applicable to the 2009 loan cohort year follow:

**Subsidy Rates—Cohort 2009**

| | Interest Differential/ Supplements | Defaults | Fees | Other | Total |
|---|---|---|---|---|---|
| Direct Loan Program | (24.82%) | 2.90% | (1.42%) | 8.38% | (14.96%) |
| TEACH Program | (15.44%) | 0.56% | (0.00%) | 11.24% | (3.64%) |
| FFEL Program (Post-1991): | | | | | |
| Guaranteed Loan Program | (2.47%) | 0.24% | (2.12%) | 1.36% | (2.99%) |
| Temporary Loan Purchase Authority: | | | | | |
| Loan Purchase Commitment | (28.35%) | 0.98% | 2.33% | 10.01% | (15.03%) |
| Loan Participation Purchase | (23.98%) | 0.97% | 0.94% | 10.34% | (11.73%) |
| ABCP Conduit | (6.92%) | 0.00% | (5.30%) | 6.78% | (5.44%) |

The subsidy rate represents the subsidy expense of the program in relation to the obligations or commitments made during the fiscal year. The subsidy expense for new direct or guaranteed loans reported in the current year relate to disbursements of loans from both current and prior years' cohorts. Subsidy expense is recognized when the Department disburses direct loans or third-party lenders disburse guaranteed loans. The subsidy expense reported in the current year also includes modifications and re-estimates. The subsidy rates shown above, which reflect aggregate negative subsidy in the FY 2009 cohort, cannot be applied to direct or guaranteed loans disbursed during the current reporting year to yield the subsidy expense, nor are these rates applicable to the portfolio as a whole.

The costs of the Department's student loan programs, especially the Direct Loan Program, are highly sensitive to changes in actual and forecasted interest rates. The formulas for determining program interest rates are established by statute; the existing loan portfolio has a mixture of borrower and lender rate formulas. Interest rate projections are based on probabilistic interest rate scenario inputs developed and provided by OMB.

### Administrative Expenses

Administrative Expense for the years ended September 30, 2009 and 2008, consisted of the following:

**Administrative Expense**
(Dollars in Millions)

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | Direct Loan Program | FFEL Program | Direct Loan Program | FFEL Program |
| Operating Expense | $ 458 | $ 269 | $ 343 | $ 222 |
| Other Expense | 23 | 13 | 14 | 9 |
| **Administrative Expenses** | **$ 481** | **$ 282** | **$ 357** | **$ 231** |

## Note 7. General Property, Plant and Equipment

General Property, Plant and Equipment, as of September 30, 2009 and 2008, consisted of the following:

**General Property, Plant and Equipment**
(Dollars in Millions)

| | 2009 | | |
|---|---|---|---|
| | Cost | Accumulated Depreciation | Net Asset Value |
| Information Technology, Internal Use Software and Telecommunications Equipment | $ 112 | $ (78) | $ 34 |
| Furniture and Fixtures | 2 | (2) | - |
| **General Property, Plant and Equipment** | **$ 114** | **$ (80)** | **$ 34** |

| | 2008 | | |
|---|---|---|---|
| | Cost | Accumulated Depreciation | Net Asset Value |
| Information Technology, Internal Use Software and Telecommunications Equipment | $ 104 | $ (61) | $ 43 |
| Furniture and Fixtures | 2 | (2) | - |
| **General Property, Plant and Equipment** | **$ 106** | **$ (63)** | **$ 43** |

The majority of the asset costs relate to financial management systems and other information technology and communications improvements.

### Leases

Federal Student Aid leases information technology and telecommunications equipment as part of a contractor-owned contractor-operated services contract. Lease payments associated with the equipment are classified as operating leases and as such are expensed as incurred. The non-cancelable lease term is one year, with the right to extend the lease term by exercising additional one-year options.

## Note 8. Other Assets

Other Assets (with the public) consist of payments made to grant recipients in advance of their expenditures and in-process invoices for interest benefits and special allowances for the FFEL Program. Other Assets (with the public) were $272 million and $37 million as of September 30, 2009 and 2008, respectively.

## Note 9. Debt

Debt as of September 30, 2009 and 2008 consisted of the following:

**Debt**

(Dollars in Millions)

| | 2009 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Accrued Interest | New Borrowing | Repayments | Ending Balance |
| **Treasury Debt** | | | | | |
| Direct Loan Program | $ 117,419 | $ - | $ 47,179 | $ (10,380) | $ 154,218 |
| FFEL Program | | | | | |
| Guaranteed Loan Program | - | 12 | 1,462 | - | 1,474 |
| Loan Purchase Commitment | 69 | - | 24,811 | (3) | 24,877 |
| Loan Participation Purchase | 10,754 | - | 43,223 | - | 53,977 |
| ABCP Conduit | - | - | 250 | (6) | 244 |
| TEACH Program | 14 | - | 56 | (2) | 68 |
| **Total** | **$ 128,256** | **$ 12** | **$ 116,981** | **$ (10,391)** | **$ 234,858** |

**Debt**

(Dollars in Millions)

| | 2008 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Accrued Interest | New Borrowing | Repayments | Ending Balance |
| **Treasury Debt** | | | | | |
| Direct Loan Program | $ 103,893 | $ - | $ 28,172 | $ (14,646) | $ 117,419 |
| FFEL Program | | | | | |
| Guaranteed Loan Program | - | - | - | - | - |
| Loan Purchase Commitment | - | - | 69 | - | 69 |
| Loan Participation Purchase | - | - | 10,754 | - | 10,754 |
| ABCP Conduit | - | - | - | - | - |
| TEACH Program | - | - | 26 | (12) | 14 |
| **Total** | **$ 103,893** | **$ -** | **$ 39,021** | **$ (14,658)** | **$ 128,256** |

The amount available for repayments on borrowings to Treasury is derived from many factors. For instance, beginning of the year cash balances, collections and new borrowings have an impact on the cash available to repay Treasury. Cash is also held to cover future liabilities, such as contract collection costs and disbursements in transit.

## Note 10. Other Liabilities

Other liabilities include current and non-current liabilities. The non-current liabilities primarily relate to the student loan receivables of the Federal Perkins Loan Program, which when collected, will be returned to the General Fund of Treasury.

The current liabilities covered by budgetary resources primarily consist of negative subsidy transfers and downward subsidy re-estimates, which when executed will be paid to Treasury.

Other Liabilities as of September 30, 2009 and 2008 consisted of the following:

### Other Liabilities

(Dollars in Millions)

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | Intragovern-mental | With the Public | Intragovern-mental | With the Public |
| **Liabilities Covered by Budgetary Resources** | | | | |
| **Current** | | | | |
| Employer Contributions and Payroll Taxes | $ 1 | $ - | $ 1 | $ - |
| Liability for Deposit Funds | - | 8 | - | 8 |
| Accrued Payroll and Benefits | - | 6 | - | 5 |
| Deferred Revenue | - | 467 | - | 42 |
| Liabilities in Miscellaneous Receipt Accounts | 11,209 | - | 6,834 | - |
| **Total Other Liabilities Covered by Budgetary Resources** | **11,210** | **481** | **6,835** | **55** |
| **Liabilities Not Covered by Budgetary Resources** | | | | |
| **Current** | | | | |
| Accrued Unfunded Annual Leave | - | 8 | - | 8 |
| **Non-current** | | | | |
| Accrued Unfunded FECA Liability | 1 | - | 1 | - |
| Liabilities in Miscellaneous Receipt Accounts | 184 | - | 186 | - |
| Accrued FECA Actuarial Liability | - | 5 | - | 4 |
| **Total Other Liabilities Not Covered by Budgetary Resources** | **185** | **13** | **187** | **12** |
| **Other Liabilities** | **$ 11,395** | **$ 494** | **$ 7,022** | **$ 67** |

### Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources include liabilities for which congressional action is needed before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not covered by budgetary resources totaled $198 million and $199 million as of September 30, 2009 and 2008, respectively.

As of September 30, 2009 and 2008, liabilities on the Balance Sheet totaled $276.9 billion and $186.1 billion respectively. Of this amount, liabilities covered by budgetary resources totaled $276.7 billion as of September 30, 2009, and $185.9 billion as of September 30, 2008.

## Note 11. Accrued Grant Liability

Federal Student Aid's accrued grant liability was $1,929 million and $862 million as of September 30, 2009 and 2008, respectively. The $1,067 million increase from FY 2008 to FY 2009 includes $634 million accrued grant liability for *Recovery Act* funds administered by Federal Student Aid.

## Note 12. Net Position

Unexpended appropriations as of September 30, 2009 and 2008 consisted of the following:

**Unexpended Appropriations**

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Unobligated Balances | | |
| Available | $ 10,360 | $ 1,153 |
| Not Available | 533 | 505 |
| Undelivered Orders | 15,548 | 11,814 |
| Authority Temporarily Precluded from Obligation | 887 | - |
| **Unexpended Appropriations** | **$ 27,328** | **$ 13,472** |

Federal Student Aid had Cumulative Results of Operations of $(277) million as of September 30, 2009, and $(6,273) million as of September 30, 2008. Cumulative Results of Operations consists mostly of unfunded upward subsidy re-estimates, other unfunded expenses, and net investments of capitalized assets.

## Note 13. Intragovernmental Cost and Exchange Revenue by Program

As required by the *Government Performance and Results Act of 1993*, Federal Student Aid's reporting organization has been aligned with Strategic Goal 3 presented in the U.S. Department of Education's *Strategic Plan 2007—2012*. Strategic Goal 3, Ensure the Accessibility, Affordability, and Accountability of Higher Education, and Better Prepare Students and Adults for Employment and Future Learning, is a sharply defined directive that guides divisions to carry out the vision and programmatic mission of Federal Student Aid.

The goals of the *Recovery Act* are consistent with the Department's current Strategic Goals and programs. For reporting purposes, a new American Recovery and Reinvestment Act net cost program has been created.

The following table presents Federal Student Aid's gross cost and exchange revenue by program for FY 2009 and FY 2008. Gross costs and earned revenue are classified as intragovernmental (exchange transactions between Federal Student Aid and other entities within the federal government) or with the public (exchange transactions between Federal Student Aid and non-federal entities).

### Gross Cost and Exchange Revenue by Program

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| ***Ensure Accessibility, Affordability and Accountability of Higher Education and Career and Technical Advancement*** | | |
| Intragovernmental Gross Cost | $ 10,079 | $ 6,903 |
| Public Gross Cost | (21,141) | 21,885 |
| Total Gross Program Costs | (11,062) | 28,788 |
| Intragovernmental Earned Revenue | 4,644 | 4,128 |
| Public Earned Revenue | 6,435 | 4,901 |
| Total Program Earned Revenue | 11,079 | 9,029 |
| **Total Program Cost** | **(22,141)** | **19,759** |
| ***American Recovery and Reinvestment Act*** | | |
| Intragovernmental Gross Cost | - | - |
| Public Gross Cost | 7,572 | - |
| Total Gross Program Costs | 7,572 | - |
| Intragovernmental Earned Revenue | - | - |
| Public Earned Revenue | - | - |
| Total Program Earned Revenue | - | - |
| **Total Program Cost** | **7,572** | **-** |
| **Net Cost of Operations** | **$ (14,569)** | **$ 19,759** |

## Note 14. Interest Expense and Interest Revenue

For FY 2009 and FY 2008, interest expense and interest revenue by program consisted of the following:

### Interest Expense and Interest Revenue

(Dollars in Millions)

| | 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Expenses | | | Revenue | | |
| | Federal | Non-federal | Total | Federal | Non-federal | Total |
| Direct Loan Program | $ 7,094 | $ - | $ 7,094 | $ 1,465 | $ 5,629 | $ 7,094 |
| FFEL Program | | | | | | |
| Guaranteed Loan Program | 32 | 337 | 369 | 369 | - | 369 |
| Loan Purchase Commitment | 861 | - | 861 | 563 | 298 | 861 |
| Loan Participation Purchase | 1,876 | - | 1,876 | 1,410 | 466 | 1,876 |
| ABCP Conduit | 6 | - | 6 | 5 | 1 | 6 |
| TEACH Program | 2 | - | 2 | 1 | 1 | 2 |
| **Total** | **$ 9,871** | **$ 337** | **$10,208** | **$ 3,813** | **$ 6,395** | **$10,208** |

| | 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Expenses | | | Revenue | | |
| | Federal | Non-federal | Total | Federal | Non-federal | Total |
| Direct Loan Program | $ 6,190 | $ - | $ 6,190 | $ 1,369 | $ 4,821 | $ 6,190 |
| FFEL Program | | | | | | |
| Guaranteed Loan Program | - | 1,372 | 1,372 | 1,372 | - | 1,372 |
| Loan Purchase Commitment | 3 | - | 3 | 3 | - | 3 |
| Loan Participation Purchase | 492 | - | 492 | 465 | 27 | 492 |
| ABCP Conduit | - | - | - | - | - | - |
| TEACH Program | 1 | - | 1 | 1 | - | 1 |
| **Total** | **$ 6,686** | **$ 1,372** | **$ 8,058** | **$ 3,210** | **$ 4,848** | **$ 8,058** |

Federal interest expense is recognized on the Department's outstanding debt. Non-federal interest revenue is earned on the individual loans and participation interests in FFEL loans. Federal interest revenue is earned on the uninvested fund balance with Treasury.

## Note 15. Statement of Budgetary Resources

The Statement of Budgetary Resources compares budgetary resources with the status of those resources. As of September 30, 2009, budgetary resources were $313,247 million and net outlays were $105,700 million. As of September 30, 2008, budgetary resources were $148,514 million and net outlays were $45,715 million.

### Permanent Indefinite Budget Authority

The Direct Loan, FFEL and TEACH Programs have permanent indefinite budget authority through legislation. Part D of the Direct Loan Program and Part B of the FFEL Program, pursuant to the *HEA* pertain to the existence, purpose and availability of this permanent indefinite budget authority.

### Reauthorization of Legislation

Funds for most Department programs are authorized, by statute, to be appropriated for a specified number of years, with an automatic one-year extension available under Section 422 of the *General Education Provisions Act*. Congress may continue to appropriate funds after the expiration of the statutory authorization period, effectively reauthorizing the program through the appropriations process. The current Budget of the United States Government presumes all programs continue per congressional budgeting rules.

### Obligations Incurred by Apportionment Category

Obligations incurred by apportionment category, as of September 30, 2009 and 2008, consisted of the following:

**Obligations Incurred by Apportionment Category**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Direct | | |
| Category A | $ 766 | $ 707 |
| Category B | 289,236 | 117,665 |
| Exempt from Apportionment | 79 | 5 |
| **Obligations Incurred** | **$ 290,081** | **$ 118,377** |

Category A apportionments are those resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are restricted by purpose for which obligations can be incurred. In addition, some resources are available without apportionment by OMB.

### Unused Borrowing Authority

Unused borrowing authority, as of September 30, 2009 and 2008, consisted of the following:

**Unused Borrowing Authority**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Beginning Balance, Unused Borrowing Authority** | **$ 25,650** | **$ 8,915** |
| Current Year Borrowing Authority | 200,214 | 57,743 |
| Funds Drawn From Treasury | (116,981) | (39,021) |
| Borrowing Authority Withdrawn | (2,736) | (1,987) |
| **Ending Balance, Unused Borrowing Authority** | **$ 106,147** | **$ 25,650** |

Federal Student Aid is given authority to draw funds from Treasury to finance the Direct Loan Program, the TEACH Program and activities under the temporary loan purchase authority. Unused Borrowing Authority is a budgetary resource and is available to support obligations. Federal Student Aid periodically reviews its borrowing authority balances in relation to its obligations and may cancel unused amounts.

### Undelivered Orders at the End of the Period

Undelivered orders, as of September 30, 2009 and 2008, consisted of the following:

**Undelivered Orders**
(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| Budgetary | $ 15,513 | $ 11,839 |
| Non-Budgetary | 132,278 | 40,338 |
| **Undelivered Orders (Unpaid)** | **$ 147,791** | **$ 52,177** |

Undelivered orders at the end of the period, as presented above, will differ from the undelivered orders included in the Net Position, Unexpended Appropriations. Undelivered orders for federal credit financing and liquidating funds are not funded through appropriations and are not included in Net Position. (See Note 12)

### Distributed Offsetting Receipts

The majority of the Distributed Offsetting Receipts line item on the SBR represents amounts paid from the Direct Loan Program and FFEL Program financing accounts to general fund receipt accounts for downward re-estimates and negative subsidies. In FY 2008 and prior, Federal Student Aid reported these collections as non-budgetary on the SBR. Beginning FY 2009, Federal Student Aid reclassified these collections as budgetary on the SBR. Although practice varies, this change was made to better align the Federal Student Aid's presentation of its credit activities with guidance provided by OMB and Treasury.

### Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the United States Government

Budgetary accounting as shown in the President's Budget includes a public enterprise fund that reflects the gross obligations by the FFEL Program for the estimated activity of the consolidated Federal Funds of the guaranty agencies. Ownership by the federal government is independent of the actual control of the assets. Since the actual operation of the Federal Fund is independent from the Department's direct control, budgetary resources and obligations are estimated and disclosed in the President's Budget to approximate the gross activities of the combined Federal Funds. Amounts reported on the FY 2008 Statement of Budgetary Resources for the Federal Fund are compiled through combining all guaranty agencies' annual reports to determine a net valuation amount for the Federal Fund.

## Note 16. Reconciliation of Net Cost of Operations to Budget

The Reconciliation of Net Cost of Operations (proprietary) to Budget provides information on how budgetary resources obligated during the period relate to the net cost of operations. The schedule presented in this note reconciles budgetary resources with the net cost of operations by (1) removing resources that do not fund net cost of operations and (2) including components of net cost of operations that did not generate or use resources during the year.

Components Requiring or Generating Resources in Future Periods primarily result from subsidy re-estimates that will be executed in future periods. The Reconciliation of Net Cost of Operations to Budget as of September 30, 2009 and 2008, are presented below:

## Reconciliation of Net Cost of Operations to Budget

(Dollars in Millions)

| | 2009 | 2008 |
|---|---|---|
| **Resources Used to Finance Activities** | | |
| Obligations Incurred | $ (290,081) | $ (118,377) |
| Spending Authority from Offsetting Collections and Recoveries | 55,511 | 39,710 |
| Offsetting Receipts | 31,646 | 5,778 |
| Imputed Financing from Costs Absorbed by Others | (9) | (8) |
| **Total Resources Used to Finance Activities** | **(202,933)** | **(72,897)** |
| **Resources Used to Finance Items Not Part of Net Cost of Operations** | | |
| Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided (+/-) | (95,775) | (27,062) |
| Resources that Fund Expenses Recognized in Prior Period | 1,091 | (1,104) |
| Credit Program Collections which Increase/Decrease Liabilities for Loan Guarantees, or Credit Program Receivables, Net including Allowances for Subsidy | 39,460 | 29,692 |
| Resources Used to Finance the Acquisition of Fixed Assets, or Increase/Decrease Liabilities for Loan Guarantees or Credit Program Receivables, Net in the Current or Prior Period | (147,641) | (51,678) |
| **Total Resources Used to Finance Items Not Part of the Net Cost of Operations** | **(202,865)** | **(50,152)** |
| **Components Not Requiring or Generating Resources** | | |
| Depreciation and Amortization | 330 | (451) |
| Other (+/-) | 448 | 290 |
| **Total Components of the Net Cost of Operations that Will Not Require or Generate Resources** | **778** | **(161)** |
| **Components Requiring or Generating Resources in Future Periods** | | |
| Upward/Downward Re-estimates of Credit Subsidy Expense | 10,883 | 513 |
| Increase in Exchange Revenue Receivable from the Public | 2,957 | 2,607 |
| Other (+/-) | 19 | 27 |
| **Total Components of the Net Cost of Operations that Will Require or Generate Resources in Future Periods** | **13,859** | **3,147** |
| **Net Cost of Operations** | **$ 14,569** | **$ (19,759)** |

## Note 17. American Recovery and Reinvestment Act of 2009

The *Recovery Act* provided $17,374 million for student aid administration and student financial assistance programs managed and administered by Federal Student Aid. Of this amount, $831 million will be available in FY 2010. As of September 30, 2009, *Recovery Act* funding administered by Federal Student Aid consisted of the following:

**American Recovery and Reinvestment Act of 2009**

(Dollars in Millions)

| | Appropriations | Obligations | Outlays |
|---|---|---|---|
| Student Financial Assistance* | $ 16,483 | $ 8,697 | $ 6,904 |
| Student Aid Administration | 60 | 29 | 1 |
| **Total** | **$ 16,543** | **$ 8,726** | **$ 6,905** |

*$831 million will be made available in FY 2010, resulting in total *Recovery Act* funding of $17,374 million.

**Student Financial Assistance.** The *Recovery Act* continues the Department's goal of making college affordable by providing $16,483 million for student financial assistance programs. This funding included $15,640 million in additional Pell Grant authority for low and middle-income undergraduate students and an additional $643 million was provided to increase the per grant amount by $490 to $5,350 per year. Also, $200 million was made available in the federal work study program for grants to eligible students to help finance their education through part-time employment. As of September 30, 2009, *Recovery Act* funding for student financial assistance consisted of the following:

**Student Financial Assistance**

(Dollars in Millions)

| | Appropriations | Obligations | Outlays |
|---|---|---|---|
| Federal Pell Grants | $ 15,640 | $ 7,854 | $ 6,300 |
| Mandatory Add-on to Pell Grant | 643 | 643 | 549 |
| Federal Work-Study Grants | 200 | 200 | 55 |
| **Total** | **$ 16,483** | **$ 8,697** | **$ 6,904** |

**Student Aid Administration.** The *Recovery Act* funding provided $60 million towards increasing the number of Title IV student loan servicing vehicles and improving operational performance to collect and deliver loan and grant data between program participants and the system. As of September 30, 2009, there were $29 million in obligations and $1 million in outlays.

## Note 18. Contingencies

### Guaranty Agencies

Federal Student Aid can assist guaranty agencies experiencing financial difficulties by various means. No provision has been made in the principal statements for potential liabilities related to financial difficulties of guaranty agencies because the likelihood of such occurrences cannot be estimated with sufficient reliability.

### Federal Perkins Loan Program Reserve Funds

The Federal Perkins Loan Program is a campus-based program providing financial assistance to eligible postsecondary school students. In FY 2009, the Department provided funding of 82.4 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 17.6 percent of program funding. For the latest academic year ended June 30, 2009, approximately 494 thousand loans were made, totaling approximately $954.8 million at 1,607 institutions, averaging $1,934 per loan. The Department's share of the Federal Perkins Loan Program was approximately $6.5 billion as of June 30, 2009.

In FY 2008, the Department provided funding of 83.01 percent of the capital used to make loans to eligible students through participating schools at 5 percent interest. The schools provided the remaining 16.99 percent of program funding. For the academic year ended June 30, 2008, approximately 648 thousand loans were made, totaling approximately $1.4 billion at 1,625 institutions, averaging $2,121 per loan. The Department's share of the Federal Perkins Loan Program was approximately $6.5 billion as of June 30, 2008.

Federal Perkins Loan Program borrowers who meet statutory eligibility requirements—such as service as a teacher in low-income areas, as a Peace Corps or VISTA volunteer, in the military or in law enforcement, in nursing or in family services—may receive partial loan forgiveness for each year of qualifying service. In these circumstances, a contingency is deemed to exist. Federal Student Aid may be required to compensate Federal Perkins Loan Program institutions for the cost of the partial loan forgiveness. Payments required under the Federal Perkins Loan partial forgiveness statutes do not have a material effect on Federal Student Aid's financial statements.

### Litigation and Other Claims

The Department is involved in various lawsuits incidental to its operations. In the opinion of management, the ultimate resolution of pending litigation will not have a material effect on Federal Student Aid's financial position.

### Other Matters

Some portion of the current-year financial assistance expenses (grants) may include funded recipient expenditures that are subsequently disallowed through program review or audit processes. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Federal Student Aid's financial position.

## Required Supplementary Stewardship Information

**Investment in Human Capital**
Human Capital investments are those expenses included in net cost for general public education and training programs that are intended to increase or maintain national economic productive capacity.

Expenses incurred for human capital investments consisted of the following for FY 2009 and the preceding four years:

**Summary of Human Capital Expenses**
**(Dollars in Millions)**

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| **Federal Student Aid Expense** | | | | | |
| Direct Loan Subsidy | $ (9,603) | $ 5,236 | $ (499) | $ 6,655 | $ 5,211 |
| FFEL Program Subsidy | (29,940) | (2,852) | 4,884 | 28,062 | 9,863 |
| *Recovery Act* | 7,571 | | | | |
| Grant Programs | 17,302 | 17,464 | 15,092 | 15,447 | 15,070 |
| Salaries and Administrative | 186 | 189 | 173 | 172 | 164 |
| **Total** | **$ (14,484)** | **$ 20,037** | **$ 19,650** | **$ $50,336** | **$ $30,308** |

The Direct Loan Program is a direct-lending program in which loan capital is provided to students by the federal government through borrowings from Treasury.

The FFEL Loan Program operates with state and private nonprofit guarantee agencies to provide loan guarantees and interest supplements through permanent budget authority on loans by private lenders to eligible students and parents of students. The FFEL Loan Program expenses include the Loan Participation Purchase and Loan Purchase Commitment expenses of $(2,230) million and $(1,853) million respectively.

In 2008 the *ECASLA* was enacted to ensure credit market disruptions did not deny eligible students and parents access to federal student loans for the 2008–09 academic year. The *ECASLA* authority, which originally expired on September 30, 2009, was subsequently extended through September 30, 2010, to continue to ensure unfettered access to loans through the 2009–10 academic year. The programs authorized under *ECASLA* are:

- ***Loan Participation and Loan Purchase Programs.*** Under these programs, lenders may access capital by either selling eligible FFEL loans directly to the Department or by selling the Department participation interests in eligible FFEL loans. Participating lenders represent to the Department that they will continue to participate in the FFEL Program and that when funds become reasonably available from private sources on affordable terms, they will originate new loans or acquire new loans made by other lenders. Under the Loan Participation Purchase Program, the Department offered to purchase through September 30, 2009, "participation interests" in pools of FFEL loans made for the 2008–09 academic year. By October 15, 2009, lenders must have either redeemed those loans or sold them outright to the Department. For participation interests on loans made for the 2009–10 academic year, the deadline for redemption is September 30, 2010.

- ***Short-Term Loan Purchase Program.*** From December 2008 through March 2009, the Department offered to purchase loans made for the 2007–08 academic year.

- ***Asset-Backed Commercial Paper Conduit Program.*** The Asset-Backed Commercial Paper Conduit Program was developed to provide additional liquidity to support new lending. Under this program, which began operations mid 2009, the Department entered into forward purchase commitments with a conduit. The conduit issues commercial paper backed by qualifying student loans made between October 2003 and September 2009. If the conduit is unable to retire this paper as it matures, the Department commits to provide the needed funds by purchasing the underlying student loans.

The TEACH program, authorized by the *CCRAA*, awards annual grants to students who agree to teach in a high-need subject area in a public or private elementary or secondary school that serves low-income students. If the students do not satisfy their agreement to serve, the grants are converted to Direct Unsubsidized Loans.

The *Recovery Act* provides funding for improving schools, raising students' achievement, driving reform and producing better results for children and young people for the long term health of the nation. The *Recovery Act* continues the Department's goal of making college affordable by providing additional Pell Grant authority for low and middle-income undergraduate students and increasing the amount of grants available as part of the FWS program.

Grant programs include the Pell Grant Program that awards direct grants through participating institutions to undergraduate students with financial need. Participating institutions either credit the appropriated funds to the student's school account or pay the student directly once per term. Signed into law in 2006, the ACG and the SMART Programs are available to encourage eligible students to take more challenging courses in high school and to pursue college majors in high demand in the global economy.

Federal Student Aid's programs link with the overall initiatives of the Department in enhancing education – a fundamental stepping-stone to higher living standards for American citizens. While education is vital to national economic growth, education's contribution is more than increased productivity and incomes. Education improves health, promotes social change and opens doors to a better future for children and adults.

In the past, economic outcomes, such as wage and salary levels, historically have been determined by the educational attainment of individuals and the skills employers expect of those entering the labor force. Both individuals and society as a whole continue to place increased emphasis on educational attainment as the workplace has become increasingly technological and employers now seek employees with the highest level of skills. For prospective employees, the focus on higher-level skills means investing in learning or developing skills through education. Like all investments, developing higher-level skills involves costs and benefits.

Returns, or benefits, of investing in education come in many forms. While some returns accrue for the individual, others benefit society and the nation in general. Returns related to the individual include higher earnings, better job opportunities and jobs that are less sensitive to general economic conditions. Returns related to the economy and society includes reduced reliance on welfare subsidies, increased participation in civic activities and greater productivity.

Over time, the returns of developing skills through education have become evident. Statistics illustrate the rewards of investing in postsecondary education.

## Required Supplementary Information

### United States Department of Education
### Federal Student Aid
### Combining Statement of Budgetary Resources
### For the Year Ended September 30, 2009

(Dollars in Millions)

| | Combined | | American Recovery and Reinvestment Act | |
|---|---|---|---|---|
| | Budgetary | Non-Budgetary Credit Reform Financing Accounts | Budgetary | Non-Budgetary Credit Reform Financing Accounts |
| **Budgetary Resources:** | | | | |
| Unobligated balance, brought forward, October 1 | $ 3,620 | $ 26,517 | $ | $ |
| Recoveries of prior year Unpaid Obligations | 398 | 8,035 | | |
| Budgetary Authority: | | | | |
| Appropriations | 41,960 | 130 | 16,543 | |
| Borrowing Authority (Note 15) | | 200,214 | | |
| Spending authority from offsetting collections (gross): | | | | |
| Earned | | | | |
| Collected | 1,569 | 45,512 | | |
| Change in Receivables from Federal Sources | | (3) | | |
| Subtotal | $ 43,529 | $ 245,853 | $ 16,543 | $ |
| Temporarily not available pursuant to Public Law | (887) | | | |
| Permanently not available | (688) | (13,130) | | |
| **Total Budgetary Resources (Note 15)** | **$ 45,972** | **$ 267,275** | **$ 16,543** | **$ 0** |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: Direct (Note 15) | $ 32,496 | $ 257,585 | $ 8,726 | $ |
| Unobligated Balances: Apportioned | 10,376 | 474 | 7,817 | |
| Unobligated Balance not available | 3,100 | 9,216 | | |
| **Total Status of Budgetary Resources** | **$ 45,972** | **$ 267,275** | **$ 16,543** | **$ 0** |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net: Unpaid obligations, brought forward, October 1 | $ 12,927 | $ 41,157 | $ | $ |
| Obligation Incurred, net (+/-) | 32,496 | 257,585 | 8,726 | |
| Gross Outlays | (27,295) | (157,132) | (6,905) | |
| Recoveries of prior year unpaid obligations, actual | (398) | (8,035) | | |
| Change in uncollected customer payments from Federal Sources (+/-) | | 3 | | |
| | **$ 17,730** | **$ 133,578** | **$ 1,821** | **$ 0** |
| Obligated Balance, net, end of period: | | | | |
| Unpaid Obligations | $ 17,730 | $ 133,575 | $ 1,821 | $ |
| Uncollected customer payments from Federal Sources | | 3 | | |
| **Total, unpaid obligated balance, net, end of period** | **$ 17,730** | **$ 133,578** | **$ 1,821** | **$ 0** |
| **Net Outlays:** | | | | |
| Gross Outlays | $ 27,295 | $ 157,132 | $ 6,905 | $ |
| Offsetting collections | (1,569) | (45,512) | | |
| Distributed Offsetting receipts | (31,646) | | | |
| **Net Outlays (Note 15)** | **$ (5,920)** | **$ 111,620** | **$ 6,905** | **$ 0** |

# United States Department of Education
## Federal Student Aid
## Combining Statement of Budgetary Resources
### For the Year Ended September 30, 2009

(Dollars in Millions)

| | Non ARRA Combined | | Direct Student Loan Program | |
|---|---|---|---|---|
| | Budgetary | Non-Budgetary Credit Reform Financing Accounts | Budgetary | Non-Budgetary Credit Reform Financing Accounts |
| **Budgetary Resources:** | | | | |
| Unobligated balance, brought forward, October 1 | $ 3,620 | $ 26,517 | $ 36 | $ 672 |
| Recoveries of prior year Unpaid Obligations | 398 | 8,035 | | 7,528 |
| Budgetary Authority: | | | | |
| Appropriations | 25,417 | 130 | 1,386 | |
| Borrowing Authority (Note 15) | | 200,214 | | 46,082 |
| Spending authority from offsetting collections (gross): | | | | |
| Earned | | | | |
| Collected | 1,569 | 45,512 | | 13,710 |
| Change in Receivables from Federal Sources | | (3) | | |
| Subtotal | $ 26,986 | $ 245,853 | $ 1,386 | $ 59,792 |
| Temporarily not available pursuant to Public Law | (887) | | | |
| Permanently not available | (688) | (13,130) | | (13,119) |
| **Total Budgetary Resources (Note 15)** | **$ 29,429** | **$ 267,275** | **$ 1,422** | **$ 54,873** |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: Direct (Note 15) | $ 23,770 | $ 257,585 | $ 1,386 | $ 53,750 |
| Unobligated Balances: Apportioned | 2,559 | 474 | | 92 |
| Unobligated Balance not available | 3,100 | 9,216 | 36 | 1,031 |
| **Total Status of Budgetary Resources** | **$ 29,429** | **$ 267,275** | **$ 1,422** | **$ 54,873** |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net: Unpaid obligations, brought forward, October 1 | $ 12,927 | $ 41,157 | $ | $ 20,433 |
| Obligation Incurred, net (+/-) | 23,770 | 257,585 | 1,386 | 53,750 |
| Gross Outlays | (20,390) | (157,132) | (1,386) | (51,037) |
| Recoveries of prior year unpaid obligations, actual | (398) | (8,035) | | (7,528) |
| Change in uncollected customer payments from Federal Sources (+/-) | | 3 | | |
| | **$ 15,909** | **$ 133,578** | **$ 0** | **$ 15,618** |
| Obligated Balance, net, end of period: | | | | |
| Unpaid Obligations | $ 15,909 | $ 133,575 | $ | $ 15,618 |
| Uncollected customer payments from Federal Sources | | 3 | | |
| **Total, unpaid obligated balance, net, end of period** | **$ 15,909** | **$ 133,578** | **$ 0** | **$ 15,618** |
| **Net Outlays:** | | | | |
| Gross Outlays | $ 20,390 | $ 157,132 | $ 1,386 | $ 51,037 |
| Offsetting collections | (1,569) | (45,512) | | (13,710) |
| Distributed Offsetting receipts | (31,646) | | (5,670) | |
| **Net Outlays (Note 15)** | **$ (12,825)** | **$ 111,620** | **$ (4,284)** | **$ 37,327** |

# United States Department of Education
## Federal Student Aid
## Combining Statement of Budgetary Resources
### For the Year Ended September 30, 2009

(Dollars in Millions)

| | Teach Grant Program | | Federal Family Education Loan Program | |
|---|---|---|---|---|
| | Budgetary | Non-Budgetary Credit Reform Financing Accounts | Budgetary | Non-Budgetary Credit Reform Financing Accounts |
| **Budgetary Resources:** | | | | |
| Unobligated balance, brought forward, October 1 | $ | $ 2 | $ 1,955 | $ 25,843 |
| Recoveries of prior year Unpaid Obligations | 7 | 8 | 7 | 499 |
| Budgetary Authority: | | | | |
| Appropriations | | | 1,062 | 130 |
| Borrowing Authority (Note 15) | | 84 | | 154,048 |
| Spending authority from offsetting collections (gross): | | | | |
| Earned | | | | |
| Collected | | 2 | 1,569 | 31,800 |
| Change in Receivables from Federal Sources | | | | (3) |
| Subtotal | $ 0 | $ 86 | $ 2,631 | $ 185,975 |
| Temporarily not available pursuant to Public Law | | | | |
| Permanently not available | | (2) | (662) | (9) |
| **Total Budgetary Resources (Note 15)** | **$ 7** | **$ 94** | **$ 3,931** | **$ 212,308** |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: Direct (Note 15) | $ | $ 94 | $ 1,351 | $ 203,741 |
| Unobligated Balances: Apportioned | | | 16 | 382 |
| Unobligated Balance not available | 7 | | 2,564 | 8,185 |
| **Total Status of Budgetary Resources** | **$ 7** | **$ 94** | **$ 3,931** | **$ 212,308** |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net: Unpaid obligations, brought forward, October 1 | $ 7 | $ 13 | $ 24 | $ 20,711 |
| Obligation Incurred, net (+/-) | | 94 | 1,351 | 203,741 |
| Gross Outlays | | (52) | (1,345) | (106,043) |
| Recoveries of prior year unpaid obligations, actual | (7) | (8) | (7) | (499) |
| Change in uncollected customer payments from Federal Sources (+/-) | | | | 3 |
| | **$ 0** | **$ 47** | **$ 23** | **$ 117,913** |
| Obligated Balance, net, end of period: | | | | |
| Unpaid Obligations | $ | $ 47 | $ 23 | $ 117,910 |
| Uncollected customer payments from Federal Sources | | | | 3 |
| **Total, unpaid obligated balance, net, end of period** | **$ 0** | **$ 47** | **$ 23** | **$ 117,913** |
| **Net Outlays:** | | | | |
| Gross Outlays | $ | $ 52 | $ 1,345 | $ 106,043 |
| Offsetting collections | | (2) | (1,569) | (31,800) |
| Distributed Offsetting receipts | (2) | | (25,950) | |
| **Net Outlays (Note 15)** | **$ (2)** | **$ 50** | **$ (26,174)** | **$ 74,243** |

# United States Department of Education
## Federal Student Aid
## Combining Statement of Budgetary Resources
### For the Year Ended September 30, 2009

(Dollars in Millions)

| | Grant Programs | | Administrative Funds | |
|---|---|---|---|---|
| | Budgetary | Non-Budgetary Credit Reform Financing Accounts | Budgetary | Non-Budgetary Credit Reform Financing Accounts |
| **Budgetary Resources:** | | | | |
| Unobligated balance, brought forward, October 1 | $ 1,626 | $ | $ 3 | $ |
| Recoveries of prior year Unpaid Obligations | 338 | | 46 | |
| Budgetary Authority: | | | | |
| Appropriations | 22,216 | | 753 | |
| Borrowing Authority (Note 15) | | | | |
| Spending authority from offsetting collections (gross): | | | | |
| Earned | | | | |
| Collected | | | | |
| Change in Receivables from Federal Sources | | | | |
| Subtotal | $ 22,216 | $ | $ 753 | $ |
| Temporarily not available pursuant to Public Law | (887) | | | |
| Permanently not available | (25) | | (1) | |
| **Total Budgetary Resources (Note 15)** | **$ 23,268** | **$ 0** | **$ 801** | **$ 0** |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: Direct (Note 15) | $ 20,296 | $ | $ 737 | $ |
| Unobligated Balances: Apportioned | 2,480 | | 63 | |
| Unobligated Balance not available | 492 | | 1 | |
| **Total Status of Budgetary Resources** | **$ 23,268** | **$ 0** | **$ 801** | **$ 0** |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net: Unpaid obligations, brought forward, October 1 | $ 12,500 | $ | $ 396 | $ |
| Obligation Incurred, net (+/-) | 20,296 | | 737 | |
| Gross Outlays | (16,891) | | (768) | |
| Recoveries of prior year unpaid obligations, actual | (338) | | (46) | |
| Change in uncollected customer payments from Federal Sources (+/-) | | | | |
| | **$ 15,567** | **$ 0** | **$ 319** | **$ 0** |
| Obligated Balance, net, end of period: | | | | |
| Unpaid Obligations | $ 15,567 | $ | $ 319 | $ |
| Uncollected customer payments from Federal Sources | | | | |
| **Total, unpaid obligated balance, net, end of period** | **$ 15,567** | **$ 0** | **$ 319** | **$ 0** |
| **Net Outlays:** | | | | |
| Gross Outlays | $ 16,891 | $ | $ 768 | $ |
| Offsetting collections | | | | |
| Distributed Offsetting receipts | (24) | | | |
| **Net Outlays (Note 15)** | **$ 16,867** | **$ 0** | **$ 768** | **$ 0** |

# Other Accompanying Information

## Management Challenges

For details on Federal Student Aid Management Challenges, please refer to relevant items included in the Management Challenges for FY 2010 narrative in the Management Discussion and Analysis section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

## Summary of Financial Statement Audit and Management Assurances

For details on Federal Student Aid programs, please refer to the Management's Assurance in the Management Discussion and Analysis "Analysis of Federal Student Aid's Systems, Controls and Legal Compliance" section of this document as well as the Summary of Financial Statement Audit and Management Assurance narrative in the Other Accompanying Information section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

## *Improper Payment Information Act of 2002* Reporting Details

For improper payments information, Federal Student Aid's activities are part of an overall Department integrated reporting effort. Please refer to the *Improper Payment Information Act of 2002* narrative in the Other Accompanying Information section in the Department's AFR located at http://www.ed.gov/about/reports/annual/index.html.

# Office of Inspector General Transmittal Letter

**UNITED STATES DEPARTMENT OF EDUCATION**
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

November 16, 2009

William Taggart
Chief Operating Officer
Federal Student Aid
Washington, D.C. 20202

Dear Mr. Taggart:

The enclosed reports present the results of the annual audits of Federal Student Aid's (FSA) financial statements for fiscal years 2009 and 2008, to comply with the Higher Education Act Amendments of 1998. The reports should be read in conjunction with FSA's financial statements and notes to fully understand the context of the information contained therein.

We contracted with the independent certified public accounting firm of Ernst & Young, LLP (Ernst & Young) to audit the financial statements of FSA as of September 30, 2009 and 2008, and for the years then ended. The contract required that the audits be performed in accordance with U.S. generally accepted government auditing standards and OMB's bulletin, *Audit Requirements for Federal Financial Statements.*

In connection with the contract, we monitored the performance of the audits, reviewed Ernst & Young's reports and related documentation, and inquired of its representatives. Our review was not intended to enable us to express, and we do not express, an opinion on FSA's financial statements, or conclusions about the effectiveness of internal control, whether FSA's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996, or on compliance with laws and regulations.

Ernst & Young is responsible for the attached auditor's report and the conclusions expressed in the related reports on internal control and compliance with laws and regulations. Our review disclosed no instances where Ernst & Young did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Sincerely,

/s/

Mary Mitchelson (Acting)

Enclosures

The Department of Education's mission is to promote student achievement and preparation for global competitiveness by fostering educational excellence and ensuring equal access.

# Report of Independent Auditors

ERNST & YOUNG

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703-747-1000
www.ey.com

**Report of Independent Auditors**

To the Inspector General
U.S. Department of Education

We have audited the accompanying consolidated balance sheets of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department), as of September 30, 2009 and 2008, and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of FSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04*, Audit Requirements for Federal Financial Statements*, as amended. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of FSA's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of FSA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FSA as of September 30, 2009 and 2008, and its net costs, changes in net position, and budgetary resources, for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 13, 2009, on our consideration of FSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information presented in the Management's Discussion and Analysis, required supplementary stewardship information, required supplementary information, and other accompanying information is not a required part of the basic financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements*. The other accompanying information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no opinion on it. For the remaining information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Ernst + Young LLP

November 13, 2009

# Report on Internal Control

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703-747-1000
www.ey.com

## Report on Internal Control

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2009, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FSA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of FSA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FSA's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined below. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies in internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or

ERNST & YOUNG



combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below to be significant deficiencies in internal control over financial reporting.

FSA relies on the Department's Office of Chief Financial Officer (OCFO) to provide support for FSA's financial reporting needs. Specifically, FSA has a memorandum of understanding (MOU) with OCFO that indicates that OCFO is responsible for the following: (1) preparing FSA's financial statements; (2) performing the daily operations of processing transactions in the general ledger; (3) preparing the required financial reporting to OMB and the U.S. Department of the Treasury, such as the SF-133 and the SF-224; and (4) developing and distributing accounting policies and procedures.

In addition, under the MOU, FSA is responsible for: (1) implementing accounting policies and procedures, (2) coordinating with OCFO and Budget Service on all financial reporting issues, and (3) reconciling subsidiary ledgers to supporting documentation and ledgers.

## SIGNIFICANT DEFICIENCIES

### 1. Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Modified Repeat Condition)

The Federal Credit Reform Act of 1990, as amended, was enacted to require agencies to more accurately measure and budget for the cost of federal loan programs. In implementing the requirements of the Credit Reform Act, and in complying with Federal accounting standards, agencies are required to estimate the net cost of extending credit over the life of a direct loan or guaranteed loan based on the present value of estimated net cash flows, excluding certain administrative costs. Such costs are also re-estimated on a periodic basis. While improvements have been made over the last several years, we noted that internal controls and processes surrounding the calculation and reporting of the loan liability activity and subsidy estimates should be maintained and further refined to ensure that appropriate estimates are prepared.

During FY 2008, the *Ensuring Continued Access to Student Loans Act of 2008* (ECASLA) legislation was enacted, which amended the FFEL program and provided the Secretary of Education with the authority to purchase student loans from private lenders and enter into forward commitments to purchase FFEL loans. In October 2008, the enactment of Public Law (P.L.) 110-350 extended this temporary loan purchase authority through September 30, 2010. The Department assembled a team with representatives from throughout the organization to develop, document, and implement the necessary processes surrounding the activities of the temporary loan purchase authority. Representatives included individuals from the Office of the

Report on Internal Control
Page 3

Under Secretary, OCFO, FSA, Budget Service, and Office of General Counsel. We noted that the Department and FSA implemented, accounted for, and maintained these challenging activities throughout FY 2009, with significant activity under the programs occurring in the last quarter of the fiscal year.

Management informed us that team representatives maintained communication throughout FY 2009 on both the activities related to the temporary loan purchase authority and the development of loan volume estimates and the subsidy re-estimates for all loan programs. Discussions relating to the temporary loan purchase authority activities also played an important role in developing the re-estimates for the existing direct loan and FFEL guaranteed loan programs, since all the programs are interrelated. In contrast to efforts documented from prior monthly integrated loan program meetings or subgroups or full workgroup sessions of the prior Credit Reform Workgroup, these meetings occurred on an informal basis, and limited documentation of their activities was developed. To the extent such groups execute critical review activities, they constitute a key control for the Department, and further structure around their activities can enhance confidence in the Department's estimation processes.

After identifying the challenges faced by the Department and FSA, as well as improvements in communication made or currently being made by the Department and FSA, we noted the following items that indicate management controls and analysis can be strengthened:

- The long-term cost for the credit programs is reflected in the financial statements through periodic charges for subsidy costs, adjustments or re-estimates to those subsidy costs, and loan activity, which is all recognized in the allowance for the receivables related to the direct loan (DL) program and the temporary loan purchase authority, and in the liability for the guaranteed loan (FFEL) program. The Department uses a computer-based cash flow projection model (i.e., Student Loan Model, or SLM) and OMB calculator to calculate subsidy estimates related to the loan programs that are then recorded in the allowance for subsidy or liability account. The model uses multiple sources of loan data and hundreds of complex assumptions. In order to perform a check of estimates resulting from the SLM and OMB calculator, the Department prepares a backcast, which compares the model's estimates to actual activity for the current and prior fiscal years. The SLM also produces a forecast of the expected cash flows in the current year for the outstanding loans which, when discounted, can be used to compare to the recorded activity in the general ledger. Additionally, other data analysis tools prepared by the Department, such as the cohort analysis, support more disaggregated reviews of data by cohort. The Department's financial systems are not configured to account for cash flows on a precise cohort level. Rigorous examinations using the cohort analysis data as well as comparisons using the backcast and forecast tools, and to the extent practical, recomputation of expected amounts based on loan volumes, interest rates, and simplified cash flow assumptions, can serve as key detect controls for potential undetected errors that may exist in the development of the assumption data and credit reform estimates. In some instances, we noted calculation errors in certain of the analytical tools used by the Department, including the cohort analysis, back of the envelope, and fluctuation analysis. While these errors did not impact amounts in the financial statements, the analytical tools should contain accurate information if they are to serve their purpose as a detect control. In addition, we noted no formal detail review process surrounding these tools. Implementing such a process may reduce the potential for errors occurring in the analytical tools, lead to further refinement of the tools, and facilitate their use in a reinvigorated and more formalized cross-functional review of the estimates.

- Consistent with credit reform implementation guidance, the Department relies significantly on prior patterns to estimate future cash flow activity. However, the Department should be more proactive in identifying conditions in which a refinement of such estimates should be made when circumstances suggest that fundamental patterns will change. For example, to the extent that lender or borrower behavior appears likely to have changed, or be changing, deviations from the use of historical data, or consideration of additional information to capture the impact of such changes, may be warranted in developing credit reform estimates. The current recessionary conditions, including increases in unemployment, reductions in credit availability for borrowers, and declines in home prices may have a significant impact on student loan borrowers and consequently on the Department's credit reform results. Many of these impacts have not been explicitly reflected in the Department's estimates.

  Since the Department's approach to estimating deferment, forbearance, and default rates includes unemployment and inflation rates for selected loan products, and since forecasts of these external factors are used in arriving at the projected deferment, forbearance, and default amounts, the Department's estimates would be expected to capture some of the indirect impact of the economic environment. However, since the models are estimated using data that largely do not reflect recessionary conditions and for a significant period reflect what in hindsight has been assessed to be a credit bubble, the Department could gain additional insights by performing stress-testing around its estimates and, as necessary, postulating borrower and lender behavior that may occur assuming the current economic recession lasts for varying lengths of time. This could be achieved by, for example:

  - *Cohort Analysis.* Since differences may exist in how the events in the credit crisis and broader economic recession impact borrowers at various points in their career, examining deferment, forbearance, and default rates by cohort may be beneficial. This could be achieved by comparing the rates at the same point in repayment for newer loans to those of older loans, and attempting to project changes in deterioration into default status by examining the behavior of loans that experienced an early default, deferment, or forbearance during prior downturns in the economy. This exercise would provide information regarding the extent to which there may be differences in performance across cohorts. Obtaining credit rating data for a subset of

Report on Internal Control
Page 5

borrowers may also be useful in furthering analysis and tracking borrowers' ability to pay over time.

- *Refinement of Tools to Reveal Trends in the Department's Loan Level Data.* We noted that the Department had made efforts to develop additional analytical tools utilizing the considerable data available to it, and is continuing the process to refine these tools and reports to aid in detecting trends. We also noted that the Department has made efforts to capture the impact of current economic conditions through the inclusion of an ad hoc variable in its model, which allows defaults for certain years to be at a different level than what would otherwise be predicted. Considering additional forms of stress-testing estimates or corroborating the default projections through alternative analysis could also aid the Department.
- *Unemployment Rate Forecast.* We noted that the Department's unemployment rate forecast appears to be somewhat lower than current unemployment rates. For example, the rate for FY 2009 is set to 6.77%, while monthly figures from the Bureau of Labor Statistics indicate that the unemployment rate reached 7.2% in December 2008 and has continued to climb throughout FY 2009. Considering alternative unemployment scenarios would allow the Department to test the sensitivity of the default estimates to the unemployment assumption. Such analysis may also provide useful information for stress-testing the Department's deferment and forbearance estimates, and, as warranted, aid in policy making to mitigate the impact of the current economic conditions on participants in the Department's programs and/or the costs of the programs.

**Recommendations:**

We recommend that Federal Student Aid perform the following:

1. Continue to improve the analytical tools used for the loan estimation process, working to develop formats and content that synthesize and capture loan level data available in the Department's and FSA's systems. Specifically:
   - Critically assess default rates by cohort in light of recent changes in initial defaults, and increases in deferment and forbearance activity to determine the extent to which there may be differences in performance across cohorts.
   - For a subset of borrowers, obtain credit rating data and track the borrower's ability to pay over time. Utilize the results to further analysis.
   - Perform additional forms of stress-testing estimates, such as alternative unemployment, interest rate, GDP growth, and inflation scenarios.

ERNST & YOUNG



- Perform reviews of source data included in the analytical tools to avoid errors and ensure that all analytical tools reconcile with one another to allow for their use as detect controls for loan program cost estimates.

2. Continue efforts to more fully implement cohort reporting with specific research on whether balances in the Department's and FSA's financial records are supported by estimates, by cohort, from the SLM and the cohort analysis tool and that remaining credit reform estimates for each cohort are appropriate in relation to the remaining outstanding loans for such cohorts. Beginning initially with direct loans, utilize detail loan level data in NSLDS to develop summary cohort level data for each year of outstanding balances for comparison to projected future cash flows from liquidation of the loans as reflected in the SLM and cohort analysis tool.

3. Document in detail the consideration and ultimate resolution of scenarios under which early warnings from patterns in Department and FSA data and other indicators of stress on program participants would be expected to lead to model adjustments in anticipation of likely changes in cash flows and result in changes in credit reform estimates. Similarly, capture the value of financial-related data for the programs to provide information for decision-makers regarding possible prospective changes in the programs based upon indications of program participant performance, stress, and anticipated changes in behavior in response to changing market and economic conditions.

4. Reinforce the role of cross-functional teams, including members from OCFO, FSA, Budget Service, Office of Postsecondary Education (OPE), and OMB, in conducting integrated loan program meetings to review reports developed as part of the cohort analysis, critical assumptions in the models, and to discuss key internal issues and trends related to the portfolios. Document these activities and decisions reached in meeting minutes with copies of the distributed materials.

**2. Controls Surrounding Information Systems Need Enhancement (Modified Repeat Condition)**

In connection with the annual audit of FSA's FY 2009 financial statements, we conducted a controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular A-130, *Management of Federal Information Resources*, requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resource management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system.

The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* identifies five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communications, and Monitoring. With respect to the Control Environment and Monitoring components, the GAO publication states that:

- "Management and employees should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control and conscientious management," and
- "Internal control monitoring should assess the quality of performance over time and ensure that the findings of audit and other reviews are promptly resolved."

While the Department and FSA have worked towards strengthening and improving controls over information technology processes during FY 2009, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of information technology general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator accounts at the application, operating system, and/or database layers; (2) access for terminated users was not removed in a timely manner or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access; (4) password configurations for applications, operating systems, and/or databases did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date.

The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during FY 2009. The OIG noted that the Department and FSA should improve security controls over the certification and accreditation (C&A) process for information systems to adequately protect the confidentiality, integrity, and availability of Department and FSA systems and the data residing in the systems. In addition, OIG noted that the Department needs to improve security controls over its incident response and handling program and accelerate two-factor authentication for protecting Privacy Act information to adequately protect the confidentiality, integrity, and availability of the personally identifiable information (PII) data residing on public web sites. During the audit, OIG also identified significant conditions related to the work performed regarding Intrusion Detection System (IDS) configuration and public domain web site establishment and maintenance.

In addition, several of the above deficiencies are repeat conditions (although for different platforms or systems) that were noted in our work and in the OIG's audit reports, an indication that the control environment and monitoring components of internal controls at the Department and FSA require additional focus.

**Recommendation:**

Applications and related infrastructure are supported by a number of separate groups within the Department and FSA. While these groups have attempted to implement controls promulgated by Department, FSA, OMB, and NIST guidelines, control processes and practices continue to be implemented in a disparate manner across these groups. In addition, audit resolution activities have traditionally been performed by each separate group and have largely focused around addressing the immediate security and control weaknesses identified by audit reports.

We recommend that the Department and FSA continue their efforts to address security and control weaknesses disclosed in audit reports or identified in internal self-assessments with an emphasis on addressing the root cause of the security or control weakness uniformly across the organization, which should decrease the likelihood of a similar weaknesses being identified in future audit assessments and internal self-assessments. Examples of addressing root causes may include, but are not limited to, additional training for the information technology professionals within the organization, allocating appropriate resources and subject matter resources to the information technology process area, maintaining updated procedures to ensure proper configuration of servers against documented standards at the time of changes in the environment, and monitoring of contract performance of vendors providing system support services to the Department and FSA. As appropriate, the specific security and government standards that are to be applied, and approaches to achieving and monitoring such compliance, continue to merit additional focus in contracts the Department and FSA execute with service providers.

More specifically, the Department and FSA should: (1) implement standards around the logging of privileged user access and activities and establish controls over the monitoring of that access; (2) strengthen access controls to protect mission critical systems (e.g., periodic access revalidation, timely removal of user access, enforcement of changes in access due to changes in roles and responsibilities); (3) improve the configuration management process to ensure consistent security configuration of servers and mainframe security packages across the organization and improve configuration settings to comply with Department and FSA policy; (4) strengthen incident handling and response procedures; (5) enhance security training and awareness programs, specifically around actions to be taken in the event an employee encounters suspicious activity; (6) document and update, as required, information pertaining to system interfaces, including Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding; (7) update system security plans and other documentation

ERNST & YOUNG



related to the C&A of existing systems, including documentation to support the authorization to operate (ATO); and (8) perform Privacy Impact Assessments (PIA) for systems containing PII and improve security controls over the protection of PII.

**STATUS OF PRIOR YEAR FINDINGS**

In the reports on the results of the FY 2008 audit of Federal Student Aid's financial statements, a number of issues were raised relating to internal control. The chart below summarizes the current status of the prior year items:

Summary of FY 2008 Significant Deficiencies

| Issue Area | Summary Control Issue | FY 2009 Status |
|---|---|---|
| Continued Focus on Credit Reform Estimation and Financial Reporting Processes is Warranted (Significant Deficiency) | Management controls and analysis need to be strengthened over credit reform estimation and financial reporting processes. | Modified Repeat Condition classified as a Significant Deficiency |
| Controls Surrounding Information Systems Need Enhancement (Significant Deficiency) | Improvements are needed in overall information technology security and systems. | Modified Repeat Condition classified as a Significant Deficiency |

We have reviewed our findings and recommendations with FSA management. Management generally concurs with our findings and recommendations and will provide a corrective action plan to the OIG in accordance with applicable Department directives.

This report is intended solely for the information and use of the management of FSA and the Department, OMB, Congress, and the Department's OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 13, 2009

A member firm of Ernst & Young Global Limited

# Report on Compliance with Laws and Regulations

Ernst & Young LLP
8484 Westpark Drive
McLean, VA 22102

Tel: 703-747-1000
www.ey.com

## Report on Compliance with Laws and Regulations

To the Inspector General
U.S. Department of Education

We have audited the consolidated balance sheet of Federal Student Aid (FSA), a performance-based organization of the U.S. Department of Education (the Department) as of September 30, 2009, and the related consolidated statements of net cost, and changes in net position, and the combined statement of budgetary resources for the fiscal year then ended, and have issued our report thereon dated November 13, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of FSA is responsible for complying with laws and regulations applicable to the entity. As part of obtaining reasonable assurance about whether the entity's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to FSA.  Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

Under FFMIA, we are required to report whether FSA's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this reporting requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

Report on Compliance with Laws and Regulations
Page 2

The results of our tests disclosed instances in which the Department's financial management systems did not substantially comply with certain requirements discussed in the preceding paragraph. FSA relies on the Department's systems to provide support for FSA's financial reporting needs, including utilizing the Department's general ledger to process transactions. We have identified the following instance of noncompliance:

While the Department and FSA have worked towards strengthening and improving controls over information technology processes during FY 2009, our audit work and audit reports prepared by the Office of Inspector General (OIG) continue to identify certain control weaknesses, including repeat conditions, within information technology security and systems, that need to be addressed. During our review of information technology general controls at the Department and FSA, we identified the following deficiencies: (1) lack of monitoring of the activities of administrator accounts at the application, operating system, and/or database layers; (2) access for terminated users was not removed in a timely manner or not removed at all; (3) revalidation of users' rights is not consistently performed for all applications and users and for those revalidations that are performed, we noted instances in which there was no validation of the appropriateness of user access; (4) password configurations for applications, operating systems, and/or databases did not comply with the relevant Department or FSA policy; (5) documentation and related approvals required to provision user access are not consistently maintained; (6) administrator level access was assigned to individuals not requiring elevated privileges; and (7) documentation related to interfaces, including but not limited to Interface Control Documents, Trading Partner Agreements, and Memorandums of Understanding, were not up to date. The OIG has identified information technology related deficiencies for the Department and FSA in reports issued during FY 2009. The OIG noted that the Department and FSA should improve security controls over the certification and accreditation (C&A) process for information systems to adequately protect the confidentiality, integrity, and availability of Department systems and the data residing in the systems. In addition, OIG noted that the Department needs to improve security controls over its incident response and handling program and accelerate two-factor authentication for protecting Privacy Act information to adequately protect the confidentiality, integrity, and availability of the personally identifiable information (PII) data residing on public web sites. During the audit, OIG also identified significant conditions related to the work performed regarding Intrusion Detection System (IDS) configuration and public domain web site establishment and maintenance.

Our Report on Internal Control dated November 13, 2009, includes additional information related to the financial management systems that were found not to comply with the requirements of FFMIA relating to information technology security and controls. It also provides information on the responsible parties, relevant facts pertaining to the noncompliance with FFMIA, and our recommendations related to the specific issues. We have reviewed our findings and recommendations with management of the Department and FSA. Management concurs with our recommendations and, to the extent findings and recommendations were noted in prior years,

Report on Compliance with Laws and Regulations
Page 3

has provided a proposed action plan to the OIG in accordance with applicable Department directives. We did not audit management's proposed action plan and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management of FSA and the Department, OMB, Congress, and the Department's OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 13, 2009

# Management's Response

START HERE
GO FURTHER
FEDERAL STUDENT AID

November 10, 2009

MEMORANDUM

TO: Mary Mitchelson
Acting Inspector General

FROM: John W. Hurt, III
Chief Financial Officer
Federal Student Aid

John W. Hurt III

SUBJECT: DRAFT AUDIT REPORTS
Fiscal Years 2009 and 2008 Financial Statement Audit
U.S. Department of Education
ED-OIG/A17J0002

Federal Student Aid appreciates the efforts and professionalism of the Office of Inspector General and our auditors, Ernst & Young, LLP, in their audit of our fiscal year 2009 financial statements. We concur with the findings and recommendations as identified in the Report on Compliance with Laws and Regulations and Report on Internal Control provided to Federal Student Aid on November 2, 2009.

Federal Student Aid continues to support the Department of Education's efforts to address the significant deficiencies related to the credit reform estimation and financial reporting processes. Although we made progress during fiscal year 2009, we recognize there are opportunities for continued improvement to adapt existing practices to accommodate changes in credit reform programs and address noted deficiencies. Our goal is to assist the Department with fully institutionalizing these processes. In addition, we continue to work with the Department to further strengthen controls over information systems.

We remain committed to maintaining an unqualified opinion in future fiscal years and we will continue to prioritize corrective actions to eliminate significant deficiencies and other matters as noted in the reports.

Once again, we thank the Office of Inspector General and Ernst &Young for their efforts to complete a successful audit of Federal Student Aid's financial statements.

# Glossary of Acronyms and Terms

| Acronym | Description |
|---|---|
| ABCP | Asset-Backed Commercial Paper |
| ACG | Academic Competitiveness Grant |
| ACSI | American Customer Satisfaction Index |
| AFR | Agency Financial Report |
| Caucus | Student Loan Ombudsman Caucus |
| *CCRAA* | *College Cost Reduction and Access Act of 2007* |
| CDR | National Cohort Default Rate |
| CLTDR | Cumulative Lifetime Default Rate |
| CPS-FAA | Central Processing System - Financial Aid Administrator |
| *Credit Reform Act* | *Federal Credit Reform Act of 1990* |
| CSRS | Civil Service Retirement System |
| DMCS | Debt Management Collection System |
| Department | U.S. Department of Education |
| Direct Loan | William D. Ford Federal Direct Loan |
| DOL | U.S. Department of Labor |
| *ECASLA* | *Ensuring Continued Access to Student Loans Act of 2008* |
| EDSS | Enterprise Development Support Services |
| ELT | Eligible Lender Trustee |
| ESB | Enterprise Services Bus |
| FAFSA | Free Application for Federal Student Aid |
| FBI | Federal Bureau of Investigation |
| FECA | Federal Employees' Compensation Act |
| Federal Fund | Federal Student Loan Reserve Fund |
| FERS | Federal Employees Retirement System |
| FFEL | Federal Family Education Loan |
| *FMFIA* | *Federal Managers' Financial Integrity Act* |
| FOTW | FAFSA on the Web |
| FSEOG | Federal Supplemental Educational Opportunity Grant |
| FWS | Federal Work-Study |
| FY | Fiscal Year |
| GAO | Government Accountability Office |
| *HEA* | *Higher Education Act of 1965, as amended* |
| *HEOA* | *Higher Education Opportunity Act of 2008* |
| *HERA* | *Higher Education Reconciliation Act of 2005* |
| IPM | Integrated Partner Management |
| IRS | Internal Revenue Service |
| IT | Information Technology |
| LEAP | Leveraging Educational Assistance Partnership |
| NA | Data is not available |
| NSLDS | National Student Loan Data System |

| Acronym | Description |
|---|---|
| OCTS | Ombudsman Case Tracking System |
| OMB | Office of Management and Budget |
| OPM | Office of Personnel Management |
| Opinion | Report of Independent Auditors |
| Pell Grant | Federal Pell Grant |
| P.L. | Public Law |
| P/PM | Project and Program Management |
| PLUS | Parent Loan for Undergraduate Students |
| PM | Measured performance, standards and/or targets were not established |
| PMA | President's Management Agenda |
| PBO | Performance-Based Organization |
| PRMS/PIN-R | Person Record Management System and Personal Identification Number Reengineering |
| *Recovery Act* | *American Recovery and Reinvestment Act of 2009* |
| SAP | Special Allowance Payment |
| SLEAP | Special Leveraging Educational Assistance Partnership |
| SMART | National Science and Mathematics Access to Retain Talent Grant |
| T | Measure was replaced or discontinued |
| TEACH | Teacher Education Assistance for College and Higher Education Grant |
| Title IV | Title IV of the *Higher Education Act of 1965, as amended* |
| TPD | Total and Permanent Disability |
| Treasury | U.S. Department of the Treasury |
| U.S. | United States |
| U.S.C. | United States Code |

# Availability of Federal Student Aid's Annual Report

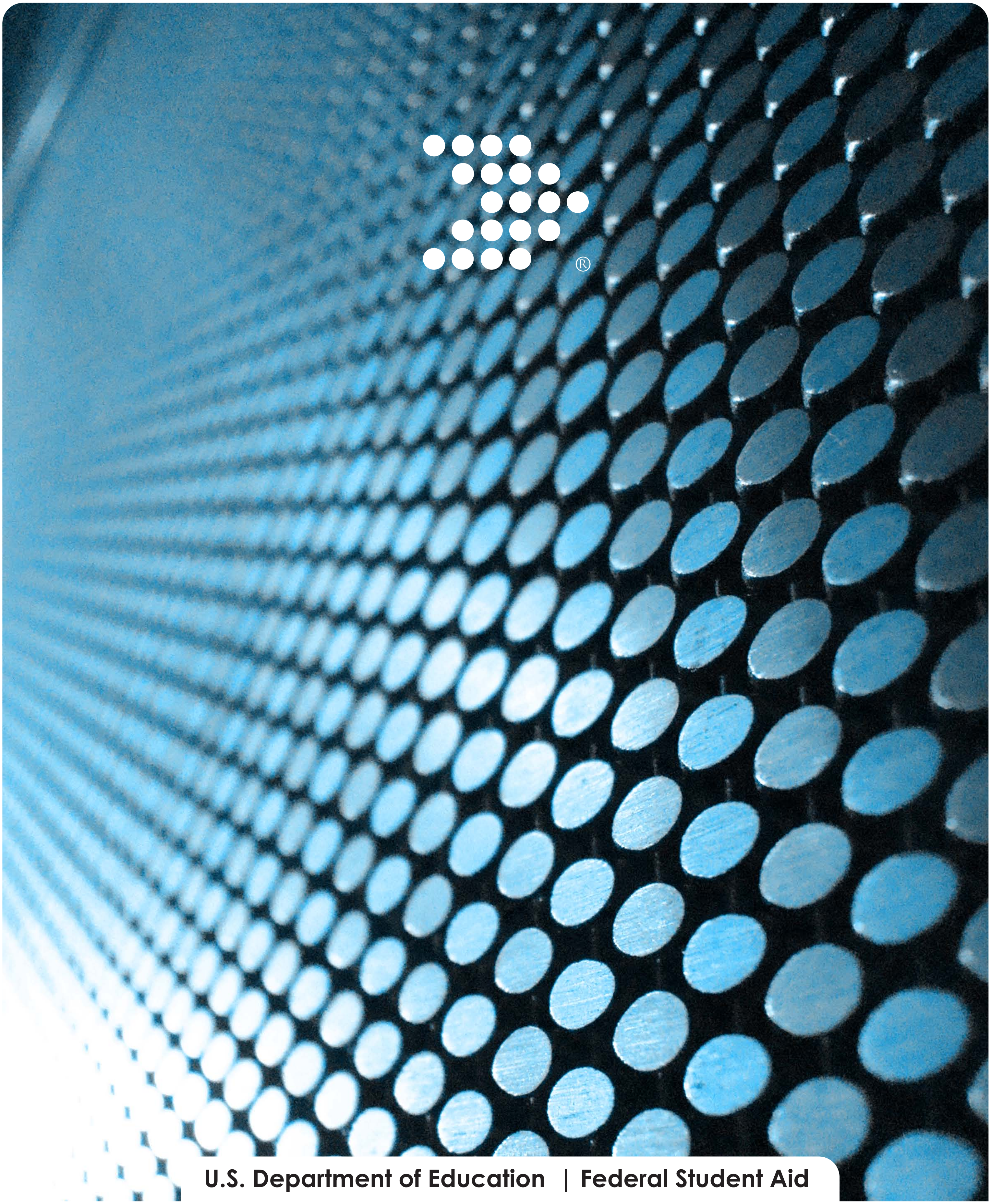
The following company was contracted to assist in the preparation of Federal Student Aid's FY 2009 *Annual Report*:

For Web design: ICF Macro

Federal Student Aid's publicly available *FY 2009 Annual Report* is accessible on Federal Student Aid's and the Department's Web sites at:

http://www.federalstudentaid.ed.gov

http://www.ed.gov/about/reports/annual/index.html



U.S. Department of Education | Federal Student Aid

START HERE
GO FURTHER
FEDERAL STUDENT AID